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2966 No. 15066

United States
Court of Appeals
for the Ninth Circuit

BERNARD BLOCH,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Transcript of Record

Appeal from the United States District Court for the District of Arizona

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.—5-11-56

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

ATTORNEYS OF RECORD

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Attorneys for Appellee.

In the United States District Court
for the District of Arizona

No. C-12340 Phx.

UNITED STATES OF AMERICA,

Plaintiff,

vs.

BERNARD BLOCH,

Defendant.

INDICTMENT

(Viol.: 26 U.S.C. 2554(a) and 26 U.S.C. 2554(g)—Sale of narcotics not pursuant to written order form, and obtaining narcotics by means of order forms not pursuant to lawful business nor legitimate practice of profession.)

The Grand Jury charges:

Count I.
(26 U.S.C. 2554(a))

That on or about the 24th day of September, 1953, within the County of Maricopa, State and District of Arizona, Bernard Bloch, did then and there knowingly, wilfully, fraudulently and feloniously sell to one R. S. Cantu, a certain quantity of narcotic drug, to wit, approximately 10 c.c. of morphine sulfate, which said sale was not in pursuance of a written order of the said R. S. Cantu to the said Bernard Bloch on a form issued in blank for that purpose by the Secretary of the Treasury of the

United States, as required by Act of Congress of December 17, 1914, and which said sale was not in the course of professional practice as a physician, and R. S. Cantu not being a patient of the said Bernard Bloch, and which said sale was not pursuant to a prescription.

Count II.
(26 U.S.C. 2554(a))

On or about the 29th day of October, 1953, within the County of Maricopa, State and District of Arizona, Bernard Bloch did then and there, knowingly, wilfully, fraudulently and feloniously sell to one R. S. Cantu a certain quantity of narcotic drug, to wit, approximately 10 c.c. morphine solution, which said sale was not in pursuance of a written order of the said R. S. Cantu to the said Bernard Bloch, on a form issued in blank for that purpose by the Secretary of the Treasury of the United States, as required by law, and which said sale was not in the course of professional practice as a physician, nor pursuant to a prescription.

Count IV.
(26 U.S.C. 2554(a))

On or about the 30th day of October, 1953, within the County of Maricopa, State and District of Arizona, Bernard Bloch did unlawfully, wilfully, fraudulently and feloniously sell to one R. S. Cantu a certain quantity of narcotic drugs, to wit, two 1/20 grain tablets of dilaudid, and 10 c.c. of mor-

phine, which sale was not in pursuance of a written order of the said R. S. Santu to the said Bernard Bloch on a form issued in blank for that purpose by the Secretary of the Treasury of the United States, as provided by law, and which said sale was not in the course of professional practice as a physician and not pursuant to a prescription.

Count V.
(26 U.S.C. 2554(a))

On or about November 10, 1953, within the County of Maricopa, State and District of Arizona, Bernard Bloch, did unlawfully, fraudulently and feloniously sell to one R. S. Cantu a certain quantity of narcotic drug, to wit, 30 c.c. of morphine hydrochloride which said sale was not in pursuance of a written order of the said R. S. Cantu to the said Bernard Bloch on a form issued in blank for that purpose by the Secretary of the Treasury of the United States, as is required by law, the said R. S. Cantu not being then and there a patient of the said Bernard Bloch, the said morphine being then and there sold and distributed by the said Bernard Bloch, not in the course of his professional practice as a physician, and not pursuant to a prescription.

Count VII.
(26 U.S.C. 2554(a))

On or about the 16th day of November, 1953, within the County of Maricopa, State and District of Arizona, Bernard Bloch did unlawfully, wilfully

and feloniously sell to one R. S. Cantu a certain quantity of narcotic drug, to wit, 10 c.c. of morphine solution, which said sale was not in pursuance of a written order of the said R. S. Cantu to the said Bernard Bloch on a form issued in blank for that purpose by the Secretary of the Treasury of the United States, as required by law, and the said R. S. Cantu not being then and there a patient of the said Bernard Bloch, and the said narcotic drug was not sold by the defendant Bernard Bloch in the course of his professional practice as a physician, and not sold pursuant to a prescription.

Count VIII.
(26 U.S.C. 2554(a))

On or about the 19th day of November, 1953, within the County of Maricopa, State and District of Arizona, Bernard Bloch did unlawfully, intentionally and feloniously sell to one R. S. Cantu a certain quantity of narcotic drug, to wit, approximately 20 c.c. of morphine, which said sale was not in pursuance to the written order of the said R. S. Cantu to the said Bernard Bloch on a form issued for that purpose by the Secretary of the Treasury of the United States, as required by law, and the said R. S. Cantu was not then and there a patient of the said Bernard Bloch, and the said narcotic drug was then and there sold by defendant Bernard Bloch not in the course of his professional practice as a physician, and not pursuant to a prescription.

A True Bill.

/s/ JO ABBOTT,
Foreman.

/s/ JACK D. H. HAYS,
United States Attorney.

[Endorsed]: Filed March 1, 1954.

[Title of District Court and Cause.]

VERDICT

We, the Jury, duly empaneled and sworn in the above-entitled action, upon our oaths, do find the defendant, Bernard Bloch, Guilty as charged in count 1; Guilty as charged in count 2; Guilty as charged in count 4; Guilty as charged in count 5; Guilty as charged in count 7; Guilty as charged in count 8.

/s/ JAMES W. ENYAIT,
Foreman.

May 27th, 1954.

[Endorsed]: Filed May 27, 1954.

In the United States District Court
for the District of Arizona
No. C-12340 Phx.

UNITED STATES OF AMERICA,
Plaintiff,

vs.

BERNARD BLOCH,
Defendant.

JUDGMENT AND COMMITMENT

On this 6th day of July, 1954, at Phoenix, Arizona, came the attorney for the Government and the defendant appeared in person and by counsel.

It Is Adjudged that the defendant has been convicted upon his plea of not guilty and a verdict of guilty of the offense of violating Title 26, United States Code, Section 2554(a), (Unlawful and felonious sale of narcotics), as charged in counts 1, 2, 4, 5, 7 and 8.

The Court having asked the defendant whether he has anything to say why judgment should not be pronounced, and no sufficient cause to the contrary being shown or appearing to the Court, It is Adjudged that the defendant is guilty as charged and convicted.

It Is Adjudged that the defendant is hereby committed to the custody of the Attorney General or his authorized representative for imprisonment for a period of two (2) years.

It Is Ordered that the Clerk deliver a certified copy of this judgment and commitment to the

United States Marshal or other qualified officer and that the copy serve as the commitment of the defendant.

/s/ DAVE W. LING,
United States District Judge.

[Endorsed]: Filed July 6, 1954.

In the United States District Court
for the District of Arizona

No. C-12340 Phx.

UNITED STATES OF AMERICA,
Plaintiff,

vs.

BERNARD BLOCH,
Defendant.

AMENDED MOTION FOR NEW TRIAL
Monday, December 20, 1954

Before: Honorable Dave W. Ling, Judge.

Appearances:

JACK D. H. HAYS,
U. S. District Attorney, By
ROBERT S. MURLLESS,
Asst. U. S. District Attorney,
For the Plaintiff.

FRANK E. FLYNN,
For the Defendant.

The Clerk: C-12,340, United States of America vs. Bernard Bloch. Defendant's amended motion for new trial.

Mr. Murlless: The Government is ready, your Honor.

Mr. Flynn: Ready.

The Court: What is the ruling of the Court of Appeals in regard to this motion?

Mr. Flynn: I don't have the case, your Honor, but under Rule 33, the case is cited in Government counsel's memorandum citing the cases, and in substance the Circuit Court of Appeals held that a motion for new trial on the grounds of newly discovered evidence while an appeal was pending—and petition was made to remand in that case as in this case—and in that decision they held they would not rule upon the petition to remand until there was an indication from the trial court as to whether or not he would grant the motion if it were before him.

I don't know any other way to get that indication except by hearing. The Court can't grant it because the jurisdiction is now in the Circuit Court, but if the record would show the indication we would have something to go on.

The Court: All right. Go ahead. Do you want to call some witnesses?

Mr. Flynn: Yes. I call Mr. Hernandez.

I would like to call the Court's attention that this motion is based upon the affidavit attached to it, and also [2*] the affidavit attached to the original

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

motion of Mr. Hernandez. I am not making a part of this record the affidavit of Mrs. Hernandez, but on the original motion, Hernandez's affidavit is referred to in my motion and made a part of this motion, but there are some additional facts I would like to have brought out.

The Court: All right.

GILBERT REESE HERNANDEZ

called as a witness in behalf of the Defendant, having been first duly sworn, testified as follows:

Direct Examination

By Mr. Flynn:

Q. State your full name, please?

A. Gilbert Reese Hernandez.

Q. And you live here in Phoenix?

A. Yes, sir.

Q. Are you married? A. Yes, sir.

Q. Mr. Hernandez, you were working with the Government narcotic agents in connection with the investigation of Dr. Bloch last year, is that correct, during 1953?

A. I wasn't employed by them then.

Q. Well, you worked with them. Are you the one who introduced Mr. Cantu to Dr. Bloch? [3]

A. Yes, sir.

Q. Prior to that time Dr. Bloch had been administering for you, giving you prescriptions?

A. Not prescriptions.

Q. He had been furnishing you with medicine?

A. That is right.

(Testimony of Gilbert Reese Hernandez.)

Q. That contained some narcotic, is that correct?

A. That is right.

Q. Now, at whose request did you take Mr. Cantu to Dr. Bloch's office?

A. Mr. Earl Moore, Mr. George Dowel, Mr. Ross, I guess, asked them to come to me.

Q. And who were those men? What is their business, the people you named?

A. Narcotic officers.

Q. What? A. Narcotic officers.

Q. And you did take Mr. Cantu to Dr. Bloch's office? A. That is right.

Q. And introduced him as your brother?

A. That is right.

Q. Now, at that time was Dr. Bloch informed either by you or in Cantu's presence, or by Cantu that he wanted some narcotics?

A. He wanted narcotics. He posed as my brother. [4]

Q. Yes?

A. I introduced him as my brother addict.

Q. At that time was Dr. Bloch informed by you or Mr. Cantu in the presence of all of you that Cantu was an addict and needed narcotics for himself? A. Yes, he knew that.

Q. And at that time, Mr. Hernandez, was anything said by either you or Mr. Cantu about wanting narcotics for some girls that were working for Cantu in a hotel? A. Not in my presence.

Q. Not in your presence? A. No.

Q. Were you there during all this conversation

that day? A. Yes, sir.

Q. Until you left? A. Yes, sir.

Q. Now, prior to that, or after that and prior to the trial of Dr. Bloch, or prior to his arrest, you didn't go there any more with Cantu, did you?

A. Never.

Q. Prior to that time, had you been using narcotics yourself? A. Before that?

Q. Yes. [5] A. Before we went up there?

Q. Yes. A. Yes.

Q. Where did you get the narcotics, outside of the medicine containing narcotics that Dr. Bloch gave you? Did you get any from anybody else?

A. Yes.

Q. From whom? A. Narcotic officers.

Q. Which ones?

A. Mr. Ross and Mr. Cantu.

Q. On how many occasions, and what kind of narcotics did they furnish you?

A. Opium and heroin.

Q. And did you use that for yourself, for your own use? A. Yes, sir.

Q. Now, since the trial, Mr. Hernandez, you made an affidavit setting out what occurred there at the time you introduced Cantu to Dr. Bloch, did you not? A. Yes, sir.

Q. And since that time have the narcotic agents, either Mr. Cantu or Mr. Ross, contacted you? Have they talked to you or come to see you?

A. After?

Q. Yes, any time within the last six months? [6]

A. Yes.

(Testimony of Gilbert Reese Hernandez.)

Q. And where did they see you?

A. He came to my home.

Q. Did you give, or did you sign any statements for them since that time? A. Yes.

Q. And where was that?

A. In Mr. Ross' office.

Q. And how did you get to Mr. Ross' office?

A. He came the day before to my home. He said he wanted to see me in his office. I didn't go up, and he came and picked me up and took me up to his office.

Q. He picked you up and took you up to his office? A. Yes, sir.

Q. And you made a statement or signed a written statement? A. Yes, sir.

Q. At that time was there any threat or promises by the narcotic agents before you signed that?

A. Yes, sir.

Q. What did they say?

A. For me to leave town.

Mr. Murlless: If the Court please, I object to that and move it be stricken unless he can fix the time and place and who was present. [7]

The Court: What would that have to do with the motion for new trial, something that occurred after the trial?

Mr. Flynn: Except to discredit Cantu's testimony.

The Court: The Jury believed him. I don't think that is admissible.

Mr. Flynn: That is all.

Mr. Murlless: No questions.

(Witness excused.)

Mr. Flynn: I would like to call Mr. Dobbs.

Mr. Murlless: May we move for that to be stricken out, if your Honor please, as we wish to contend that it is both irrelevant and immaterial and has no relation to the issues that were tried in the case. May the testimony of Hernandez be stricken out?

The Court: Well, there might be some few words he said that shouldn't be stricken. You make a blanket motion. I don't know what you refer to. The last part, anything that occurred subsequent to the trial, of course, you can't base a new trial on that.

Mr. Murlless: Yes. I am sure that the Government wouldn't be expected to make Hernandez its witness, but could we reserve time for the cross-examination of the witness Hernandez?

The Court: I don't understand what you are talking about.

Mr. Murlless: May we after this—we wouldn't wish, and [8] I don't think the Court would expect the Government to make Hernandez the government's witness.

The Court: I don't care what the Government does. The Government can do just as it pleases.

Mr. Flynn: Go ahead and be sworn.

BERT C. DOBBS

was called as a witness for the Defendant, and was duly sworn.

Mr. Flynn: In view of the Court's ruling, I would like to announce, in fact, make an offer of proof, and to save the time examining this witness if the Court will not permit the examination.

We offer to prove by this witness that the testimony would corroborate the testimony given by Hernandez, that Hernandez was furnished with narcotics during the time and prior to Dr. Bloch's arrest, and during the time he was connected with the investigation of Dr. Bloch.

The Court: By the narcotics officer?

Mr. Flynn: Yes, by the narcotics officer.

The Court: Well, I don't think that would make any difference one way or the other. So if there is an objection I will sustain it.

Mr. Murlless: Yes, if your Honor please.

The Court: Is there anything further the witness would testify?

Mr. Flynn: That is all, your Honor. That testimony [9] and the affidavit attached to the motion are the basis for our motion.

The Court: All right. The motion will be denied.

(Which was all the proceedings had in the above-entitled matter at said time and place.)

Certificate

I hereby certify that I am a duly appointed, qualified and acting official court reporter of the

United States District Court for the District of Arizona.

I further certify that the foregoing is a true and correct transcript of the proceedings had in the above-entitled cause on the date specified therein, and that said transcript is a true and correct transcription of my stenographic notes.

Dated at Phoenix, Arizona, this 3rd day of May, A.D. 1956.

/s/ JANE HORSWELL,
Official Reporter.

[Endorsed]: Filed May 4, 1956, U.S.D.C.

[Endorsed]: Filed May 7, 1956, U.S.C.A. [10]

[Title of District Court and Cause.]

NOTICE OF MOTION FOR NEW TRIAL

To the United States of America and to Its Attorneys, Jack D. H. Hays, United States Attorney, and Robert S. Murlless, and Deputy Holohan:

Please Take Notice that Bernard Bloch, the defendant in the above-entitled case, will move the Honorable Judge David Ling, in the United States District Court for the District of Arizona, on February 13th, 1956, at the Courthouse in Phoenix, Arizona, at the hour of 10:00 a.m., or as soon thereafter as said Motion can be heard, to vacate and set aside the judgments in the above-entitled case and grant a new trial, pursuant to Rule 33 of Rules of Criminal Procedure for the District Courts of the United

States, on each of the grounds and points and authorities set out in the written Motion attached hereto and made a part hereof, and upon the affidavits and testimony taken heretofore in support thereof.

Said Motion will be made upon the records and files of the case, the judicial notice of the opinions of the United States Court of Appeals for the Ninth Circuit, the affidavits in support of the Motion, and the testimony heretofore taken on hearing in connection with the case, and upon all the records and files and proceedings had herein, and upon the written Motion and Notice of Motion.

Dated: February 9th, 1956.

By /s/ ROBERT RENAUD,
Attorney for Defendant.

[Title of District Court and Cause.]

MOTION FOR A NEW TRIAL

Comes Now the defendant Bernard Bloch and moves for a new trial within the meaning of Rule 33 of the Rules of Criminal Procedure for the District Courts of the United States, on the following grounds, to wit:

I.

The court and jury acted under a mistake of fact at the time of the trial; namely, that the defendant was convicted of a felony, which conviction was

subsequently and since the trial of the action reversed, and therefore a new trial is required in the interest of justice, since the case rested upon the belief of the jury in the credibility of either R. S. Cantu or the defendant.

II.

The conviction is null and void as being based upon false and perjured testimony produced by an agent of the government, and knowingly used to convict the defendant; that the use of such testimony violated the defendant's constitutional rights under the due process clause of the Fifth Amendment to the Constitution of the United States.

III.

The government wilfully and deliberately suppressed evidence, to wit: The testimony of Gilbert Hernandez, employed as a special undercover agent of the government, which testimony, if produced, would have contradicted R. S. Cantu, special agent of the government, that Hernandez told the defendant Bloch that Cantu's "girls needed treatment," and that Cantu told Dr. Bloch that he had girls working for him and needed narcotics for these girls.

IV.

That the defendant was unlawfully entrapped, in violation of the due process clause of the Fifth Amendment to the Constitution of the United States, and that the judgments against him, and each of them, are null and void for that reason.

The said Motion will be based upon the judicial notice of the Court of the opinions of the United States Court of Appeals for the Ninth Circuit, in Bloch v. United States, 221 Fed. 2d 786 and 223 Fed. 2d 297, and the opinion of this court in Bloch v. United States in this case; the affidavits of Bernard Bloch, Gilbert Hernandez, and all proceedings had on the Amended Motion for a New Trial on December 20th, 1954, in the District Court of the United States at Phoenix, Arizona, including the testimony of Bert C. Dobbs and Gilbert Hernandez given at that time, and the affidavit attached to the original motion of Mr. Hernandez, and all other proceedings in the case.

McKESSON & RENAUD, and

/s/ MORRIS LAVINE,

By /s/ MORRIS LAVINE,

Attorneys for Defendant.

Points and Authorities

I.

The case against Dr. Bloch turned upon the credibility of either R. S. Cantu, a government agent, or Dr. Bloch, whose testimony was directly in conflict with that of Cantu. Therefore, the credibility of Dr. Bloch was directly in issue for the jury to determine to decide which of the two—Cantu or Dr. Bloch—it would believe. To impair the credibility of Dr. Bloch, the government asked Dr. Bloch if he had been convicted of a felony, and he replied in the affirmative, although he had not put his character in issue and the question was be-

yond the scope of any question asked on direct examination.

The jury, based upon the testimony before it that the doctor was convicted of a felony, previously, and shadowing his credibility before it, brought in a conviction in the instant case.

However, on appeal, the United States Court of Appeals for the Ninth Circuit, reversed the judgment of conviction (221 Fed. 2d 786; 223 Fed. 2d 297), and thus the defendant stands convicted on a fact that should have been non-existent at the time, namely: That he was convicted of a felony, and a fact which could not have with reasonable diligence been known until after the Court of Appeals passed upon his appeal. Hence, the defendant is entitled to a new trial in the interest of justice within the meaning of Rule 33 of the Rules of Criminal Procedure since it could not have been known until after the Court of Appeals acted in the income tax case that he did not legally stand convicted of a felony, and therefore had a right to have his cause tried before a jury without the impairment of his credibility by the asking of this question and the placing of this finally undetermined fact before the jury.

The reason for receiving evidence of a prior conviction for felony is that one so convicted deserves less credit as a witness than one who has not been so convicted. Consequently, the jury believes that fact in passing upon the credibility of the witness.

The prosecutor, in asking the question and knowing the cause was on appeal, risked the danger that if the former conviction is reversed that a new trial should be granted in the case in which that prejudicial evidence is brought out, for the defendant suffers irreparable prejudice before the jury by the disclosure of the former conviction. In this case, the testimony as between the narcotic agent Cantu and the defendant involved the credibility of one or the other. Therefore, since the first conviction was reversed, a new trial should be granted in the present case to avoid an unjust conviction. (See Campbell v. United States, 176 Fed. 45, at page 47.)

II.

The use of evidence knowingly perjured violates the due process clause of the Fifth Amendment to the Constitution of the United States and makes judgments a nullity.

Mooney v. Holohan,
292 U. S. 103, 79 L. Ed. 791;

Hysler v. Florida,
315 U. S. 411, 86 L. Ed. 934.

In Hysler v. Florida, 315 U. S. 411, 86 L. Ed. 934, the Supreme Court said:

"If a state, whether by the active conduct or the connivance of the prosecution obtains a conviction through the use of perjured testimony, it violates civilized standards for the trial of the guilt or innocence and thereby deprives an accused of liberty

without due process of law. Mooney v. Holohan, 294 U. S. 103, 79 L. Ed. 791."

A new trial may be granted where it appears that material testimony given at the trial was perjured.

United States v. Johnson,
149 Fed. 2d 31;

Martin v. United States,
17 Fed. 2d 973, Cert. denied, 275 U. S. 527,
72 L. Ed. 408.

Where the party seeking a new trial was taken by surprise when the false testimony was given and was unable to meet it, or did not know of its falsity until after the trial, he should be granted a new trial.

United States v. Johnson,
149 Fed. 2d 31.

III.

Where there is evidence in the possession of the government which would aid the defendant, the government is duty bound to produce that evidence, since the government prosecutor represents all of the people and not merely one side.

Berger v. United States,
79 L. Ed. 1314, 295 U. S. 78.

The prosecutor had a duty to produce Gilbert Hernandez, who Cantu claimed was present during conversations between Cantu and the defendant regarding the purported getting of narcotics for

"girls" who were prostitutes, which testimony Gilbert Hernandez denies in affidavits and testimony before this court.

The wilful suppression of evidence favorable to the defendant violates due process of law guaranteed by the Fifth Amendment to the Constitution of the United States. (See Smith v. O'Grady, 312 U. S. 329.)

Where the government is in possession and control of evidence which, if presented, might have materially influenced the jury to reach a different conclusion and fails to produce it and it is not available to the defense until after the trial, a new trial should be granted as such evidence is newly after the trial and is material (United States v. Smith, Fed. case No. 16341; Gichanov v. United States, 281 Fed. 125), and failure to produce it at the trial was not owing to want of diligence (Green & Moore Co. v. United States, 19 Fed. 2d 130; Silva v. United States, 38 Fed. 2d 465) and where the prosecutor did not produce it but rather prevented the defendant from being able to produce it at the trial, such procedure amounts to extrinsic fraud, for which a new trial is always proper. (U. S. v. Throckmorton, 98 U. S. 61, 25 L. Ed. 93.)

DeLouis v. Meek,
2 Green (Iowa) 55, 50 Am. Dec. 491.

Smith v. Lowry,
1 Johns (N. Y.) 320.

In Bryant v. Stilwell, 24 Pa. 314, the court said:

> "To smother evidence is not much better than to fabricate it. A party who shuts the door upon a fair examination, and thus prevents a jury from learning material facts, must take the consequence of any honest indignation which his conduct may excite * * * It ought to be understood that where one party has the subject matter of the controversy under his exclusive control, it is never safe to refuse the witnesses on the other side an opportunity to examine it unless he is able to give a very satisfactory reason."

Even the Bible condemns conduct where it is declared "cursed be he that removeth his neighbor's landmark." (Deut. C. 27, 17.)

IV.

The evidence clearly shows that the defendant was entrapped. Hernandez was a government agent and became such during his treatment by the defendant. The introduction of Cantu was for the purpose of soliciting the acts charged. Such solicitation constitutes entrapment as a matter of law.

Sorrells v. United States,
287 U. S. 435;

Newman v. United States,
299 Fed. 128, 131;

Butts v. United States,
273 Fed. 35, 38.

A judgment is a nullity at any stage of the proceedings in which entrapment is established.

Sorrells v. United States,
287 U. S. 435.

/s/ MORRIS LAVINE,
Attorney for Defendant.

[Title of District Court and Cause.]

AFFIDAVIT

State of Arizona,
County of Maricopa—ss.

Gilbert Ruiz Hernandez, being first duly sworn, upon oath, deposes and says:

That he is a citizen of the United States, and a resident of Phoenix, County of Maricopa, State of Arizona; that he has been a resident of such City, County and State for approximately ten (10) years.

That he has been addicted to the use of narcotics, and that as such an addict he became acquainted with the Federal Officers stationed at Phoenix, Maricopa County, Arizona; that among such officers were R. S. Cantu, Patrick Ross and George Dowell. That he became acquainted with R. S. Cantu some time during the year of 1952, having been introduced to him by Earl Smith, a narcotic agent located in Phoenix, Maricopa County, Arizona, now

deceased, and that thereafter he became acquainted with the other aforementioned Patrick Ross and George Dowell.

That all of said agents knew that he was addicted to the use of narcotics. That he has worked for said agents and that his compensation for his services rendered to them he has never been paid in money, except on one occasion; that all of his compensation has been in the form of narcotics, either Opium, Heroin, Dilaudide, Cocaine, or Morphine; that as compensation also his wife, to wit, Isabel Hernandez, has been given narcotics by R. S. Cantu; that during the course of his addiction he contacted Bernard Bloch, the defendant above named, relative to treatment for such addiction; that the said Bernard Bloch, did upon numerous occasions treat affiant by the administration of medication through the use of a hypodermic syringe, and did furnish to affiant medications to be self-administered.

That the aforementioned narcotic agents, to wit, R. S. Cantu, Patrick Ross and George Dowell, knew that affiant was being treated by the said Bernard Bloch.

That approximately two days prior to September 23, 1953, R. S. Cantu, one of the said and aforementioned narcotic agents, contacted affiant and requested that he go to the office of the said Bernard Bloch and obtain narcotics from the said Bernard Bloch. That at said time affiant was told by the said R. S. Cantu that in the event he failed to cooperate with the narcotic agents of the United

States Government that they would cause his probation to be revoked, and would cause him to be sent to Prison as a result of such revocation of probation. That affiant was on probation in the Superior Court of Maricopa County, State of Arizona, being under probation for a period of five (5) years as a result of Forgery; that affiant feared for his liberty as the result of said aforementioned threats on the part of said narcotic agents and, therefore, agreed to co-operate with the said narcotic agents.

That on the 23rd day of September, 1953, affiant was taken to the vicinity of the office of the said Bernard Bloch, by the said R. S. Cantu, and was told to get narcotics from the said Bernard Bloch. That the said R. S. Cantu furnished to affiant monies with which to obtain said narcotics, the exact amount of which, and the exact denomination being at this time not known to, nor remembered by affiant. That affiant did go to the said office of the said Bernard Bloch, and did request medication from the said Bernard Bloch, which said medication was given to affiant in accordance with previous practice. That the said Bernard Bloch, at said time and place did administer medication to affiant by means of a hypodermic syringe, and that affiant did take the balance of said medication with him and did give the same to the said R. S. Cantu; that thereafter affiant had conversation with the said R. S. Cantu, Patrick Ross and George Dowell, at which time affiant was told to introduce the said R. S. Cantu to the said Bernard Bloch as his

brother, Ray, and to tell the said Bernard Bloch that the said R. S. Cantu was addicted and was in need of medication of the same type which was being administered to affiant; that the said narcotic agents, R. S. Cantu, Patrick Ross and George Dowell, threatened affiant again, that if he failed to co-operate as aforementioned that they would cause his probation to be revoked, that affiant thereupon agreed to so do and on September 24, 1953, subsequent to a call being made by affiant to said Bernard Bloch, to ascertain his presence in his office, went to the office of the said Bernard Bloch with the said R. S. Cantu, and there did introduce the said R. S. Cantu, to the said Bernard Bloch, as his brother, Ray (Just arrived in Phoenix from California), and stated to the said Bernard Bloch that the said R. S. Cantu, allegedly brother of affiant, was addicted and in need of medication; that the said R. S. Cantu thereupon confirmed said statement by statements to the said Bernard Bloch, that such was a fact. That there was a conversation between affiant and the said Bernard Bloch concerning an outstanding bill owed to the said Bernard Bloch by affiant, and that affiant stated that his brother (Cantu) would pay some on said bill, which (Cantu) agreed to do. That there was stated by affiant to the said Bernard Bloch that affiant had received $20.00 from Cantu previous to the entry into the office of the said Bernard Bloch, which monies were paid to Bernard Bloch, and that Cantu, likewise, paid the said Bernard Bloch some further monies, the exact amount being by affiant not re-

membered and unknown. That affiant received a 10 cc. vial of narcotic from the said Bernard Bloch, and that thereupon affiant and Cantu left the said office of the said Bernard Bloch.

That at all times while affiant and Cantu were in the office of the said Bernard Bloch, the said R. S. Cantu was at no time out of the immediate presence of affiant; that at no time was there anything stated by the said R. S. Cantu to the said Bernard Bloch, or to anyone, that the said R. S. Cantu was a peddler of narcotics; at no time was anything stated that the said R. S. Cantu, by the said R. S. Cantu, or anyone else, that the said R. S. Cantu was in need of the said narcotics for girls who were in his employ, namely, prostitutes; that at no time was anything stated by the said R. S. Cantu, or anyone else, that narcotics were needed for any other person other than medication for himself and affiant. That thereafter affiant and the said R. S. Cantu left the office of the said Bernard Bloch, and met officers Patrick Ross and George Dowell, who were awaiting the return of affiant and the said R. S. Cantu, at which time and place there was given to affiant some several cc.'s of the said narcotic obtained from the said Bernard Bloch, the exact quantity being to the affiant unknown; the remainder of said narcotic being retained by said narcotic agents.

That shortly before the trial of the above-entitled matter in the above-entitled court, which said trial took place during the 25th, 26th and 27th of May,

1954, the exact date being not remembered by affiant. affiant was contacted by the Federal Narcotics Agents hereinbefore named, to wit, Patrick Ross. George Dowell and R. S. Cantu, together with Dale Welsh, a member of the City Police Department of the City of Phoenix, Arizona, concerning the fact that one Wade Church, a practicing attorney in Phoenix, Maricopa County, Arizona, then representing the above-named said Bernard Bloch, during the said trial, was attempting to contact affiant and that affiant was told by said Officers to avoid the said Wade Church and not to tell him anything concerning the facts of the case which the Federal Government had against the said Bernard Bloch. That thereafter the said narcotic agents again contacted affiant and told him to call the said Wade Church, and to arrange a place with him where affiant could talk to the said Wade Church, then affiant was told to inform the said Wade Church to meet him at a predesignated place at 25th Avenue and Jefferson Street, in the City of Phoenix, Maricopa County, Arizona, and from there to take him to the Plaza Apts Motel at 2511 West Van Buren Street, Phoenix, Maricopa County, Arizona, and to represent to the said Wade Church that affiant was living in said motel, Apartment 4; that affiant was told to take clothes to said Apartment 4 so that the said Wade Church would believe that he was living at said apartment; that affiant was with the said aforementioned narcotic agents and the said Dale Welsh and Bert Dobbs, another Federal Narcotic Agent, when the said Apartment 4,

in the above-mentioned motel, was wired for recording; that affiant was told that agents and officers aforementioned would be in Apartment 3 with recording equipment. That affiant did meet the said Wade Church at the corner of 25th Avenue and Jefferson Street, by prearrangement, at which time the said Wade Church requested affiant to go to his office to discuss the case against the said Bernard Bloch, that because of previous instructions given to affiant by the said Officers, affiant insisted that he would not discuss anything unless at his motel, to wit, Apartment 4, Plaza Apts Motel, as aforementioned, that the said Wade Church thereupon agreed to take affiant to the said apartment and that affiant and the said Wade Church did go to said apartment. That affiant had been previously instructed by the said aforementioned Federal Narcotic Agents and the said Police Officer Dale Welsh, not to disclose to the said Wade Church any matters concerning the evidence of the Government of the United States against the said Bernard Bloch, but instead to attempt to question the said Wade Church in such a manner so that the said Wade Church would be enticed to offer affiant a bribe for the production of testimony by affiant in behalf of the above-mentioned Bernard Bloch; that the said Wade Church did request that affiant discuss the facts of the case with him, but that as per previous instructions from the said aforementioned officers, affiant refused to disclose to the said Wade Church any of the facts concerning the evidence against the said Bernard Bloch, and stated to the said Wade Church

that he did not desire to become any more involved in the case than he already was and attempted to have the said Wade Church offer to him a bribe for his testimony, which the said Wade Church never did. That after conversation was had concerning the case against the said Bernard Bloch, and after affiant refused to divulge any information to the said Wade Church by reason of his previous instructions, the meeting between the said Wade Church and affiant broke up and the said Wade Church thereafter left affiant at the said motel, Apartment 4; that thereafter the Federal Officers expressed their disgust with affiant for his inability to entrap the said Wade Church.

That during the course of the trial of the said case against the said Bernard Bloch, affiant was secreted in a room in the Federal Building in the City of Phoenix, Maricopa County, Arizona, and instructed not to discuss the case with any person. That affiant was subpoenaed by the Government of the United States to testify at the trial of the above-named Bernard Bloch, but that affiant was not called as a witness in behalf of the Government of the United States, nor was he called as a witness at all in said matter.

That the above-named Bernard Bloch, did not know until subsequent to the trial and subsequent to his conviction what the testimony of affiant would have been had he been called as a witness either by the Government of the United States, or by the defendant Bernard Bloch; that the said Bernard

Bloch did not know of said evidence by reason of the fact that affiant refused to divulge any of said matters to the said Wade Church, by reason of instructions given to affiant under threat of revocation of probation.

That on many occasions from and after the introduction of the said R. S. Cantu to the said Bernard Bloch by affiant, the said Federal Officers threatened affiant and told him to leave Phoenix on many occasions giving affiant and his wife sufficient narcotics to dispel withdrawal symptoms while riding on the bus from Phoenix, stating that the said Bernard Bloch had employed some man with a gun to "get" (Affiant) by reason of his participation in the case against the said Bernard Bloch; that affiant would take the narcotics offered himself and his wife, and would go to the Bus Depot with the said narcotic agents, but would not leave upon the buses indicated for their departure.

/s/ GILBERT RUIZ HERNANDEZ.

Subscribed and sworn to before me this 1st day of February, 1956.

[Seal] /s/ R. N. RENAUD,
Notary Public.

My Commission Expires: 3-15-58.

[Title of District Court and Cause.]

AFFIDAVIT

Maricopa County,
State of Arizona—ss.

Wade Church, Attorney-at-Law, of Phoenix, Arizona, being first duly sworn, deposes and says:

That shortly before the trial of the above-entitled case in the district court (which trial took place on May 25th, 26th and 27th, 1954), I tried to secure a statement from one Gilbert Hernandez. After several attempts were made to locate him, I finally reached him by phone. I asked him to come to the office, or let me come to his home for the purpose. He said he did not want to come to the office, and that since his wife did not know of his troubles, he did not want to meet at his home. He said he would call and let me know where he would meet with me. He called me back and suggested that I meet him at the corner of 25th Avenue and Jefferson Street in Phoenix, Arizona. This I did. He took me to Apartment No. 4 at the Plaza Apartment Motel, located at 25th Avenue and Van Buren Streets in Phoenix, Arizona. I asked him why we were meeting here and he said that it was the room of a friend who let him use the room when he was tired. I tried to get data from him regarding this case, but he kept insisting that he ought to have something from Dr. Bloch or me for his efforts. I explained that any statement that he made would have to be voluntary and that he was promised nothing by either Dr.

Bloch or myself. He would not tell me anything about the case, unless he was paid or rewarded and so my mission proved a failure.

/s/ WADE CHURCH.

Subscribed and sworn to before me this 8th day of February, 1956.

[Seal] /s/ SADIE S. HOBBS,
Notary Public.

My Commission Expires: 1/5/59.

Receipt of copy acknowledged.

[Endorsed]: Filed February 9, 1956.

[Title of District Court and Cause.]

AFFIDAVIT OF BERNARD BLOCH

State of Arizona,
County of Maricopa—ss.

Dr. Bernard Bloch, being first duly sworn, deposes and says:

I am a licensed osteopathic physician and surgeon, licensed under the laws of the State of Arizona, and have practiced my profession at Sunnyslope, Arizona. I am a graduate of the osteopathic medical school of Chicago and subsequently had considerable hospital training and experience in my field. At the times mentioned in this affidavit, I

was duly registered as required by law and the holder of a government narcotics license.

In 1953, pursuant to the laws of the state of Arizona, I was treating a patient named Gilbert Hernandez for narcotic addiction, as permitted by the laws of my state and of the United States. I was giving him a known and accepted form of treatment, a diluted form of morphine and atropine.

I am informed and believe, and therefore allege, that Hernandez was approached by officers of the Narcotics Bureau of the United States in 1953; these officers being Pat Ross and R. S. Cantu, and that they asked that Hernandez make a case against me and promised to give him additional narcotics if he did so and would supply him with all of the narcotics that he needed, but that if he did not do so that they would arrest and put him away for a long time in jail or prison.

Hernandez was at the time on probation in the Federal Court. I am informed and believe, and therefore allege, that he was given narcotics by these narcotic agents, such narcotics not being secured in any regular manner and that such narcotics were supplied in violation of the Federal Narcotic Law itself, and from narcotics obtained from illegal sources. I am further informed and believe that neither Pat Ross or R. S. Cantu held a license or hold a license to dispense narcotics and that such giving of narcotics by such officers is not permitted by law and that narcotics may only be dispensed

with upon and by proper medical authority or upon a doctor's prescription.

I am further informed and believe that a probation officer warned these narcotics agents not to use Hernandez for the entrapment or arrest of any person.

I am further informed and believe and therefore allege that Hernandez was thereafter given pure opium and heroin by these narcotic agents in order to bring about my arrest and conviction on a charge of violating the federal narcotic laws.

I am informed and believe and therefore allege that Hernandez then became a secret and confidential agent for the United States Government for the purpose of trying to bring about my arrest and conviction on the charge of violating the narcotic laws of the United States; that he was contacted by Agent R. S. Cantu, a regular and so-called undercover agent for the Narcotic Bureau.

On September 24, 1953, my patient, Gilbert Hernandez, who had now been employed secretly by the Narcotic Bureau of the United States Government, brought Special Agent R. S. Cantu to my office and Hernandez introduced Mr. Cantu to me as his brother addict, who needed treatment for his addiction just as he, Hernandez, was receiving. Hernandez introduced Cantu as his brother, Raymond. I am informed and believe, and therefore allege, that the agent of the United States Government Cantu and Agent Ross had told Hernandez to do

this. Cantu represented that he was an addict, saying, in substance and effect, "I am an addict. I need treatment, too." Mr. Cantu told me he was a sick man and needed treatment. Mr. Cantu did have the appearance of an addict and I am informed and believe, and therefore allege, that he did use narcotics himself.

I am informed and believe from affidavits of Mr. Hernandez that Cantu has given Hernandez illegally as much as ten to fifteen grains of heroin, morphine and opium at a time, and that Mr. Cantu has taken various narcotics and has smoked marijuana with different people, and has injected himself with heroin.

At no time did Mr. Cantu tell me that he wanted any narcotics for any other persons than for his own addiction. At the time that he came and told me that he was an addict and wanted the narcotics for his own addiction. He was accompanied by Gilbert Hernandez, and at that time he made no statement that he wanted the narcotics for any other person or purpose.

During the trial of the case Mr. Cantu testified as follows:

"Q. Did Hernandez tell Dr. Block that you were in need of treatment?

"A. No, he told defendant Bloch that my girls needed treatment.

"Q. Your girls? A. That is correct.

"Q. What do you mean, your girls?

"A. I had several girls working in the resorts here.

"Q. Did you actually have any girls working in resorts? A. Certainly not.

"Q. In other words, you represented, you were stating that you represented to Dr. Block that you had some girls working in resorts?

"A. That is correct.

"Q. What kind of girls were they? Did you tell him? A. Prostitutes.

"Q. You told him they were prostitutes?

"A. That is correct.

"Q. And you told him they were working for you? A. That is right.

"Q. And you told him they needed this particular type of treatment? A. That is right.

"Q. Did you tell him that these so-called prostitutes were addicts? A. That is correct.

"Q. You told him they were addicts?

"A. That is correct.

"Q. And you told him they needed treatment for this addiction? A. That is right."

The foregoing testimony was false and was known to Cantu to be false. No such statements were made to me. Hernandez, though subpoenaed by the government, was not called as a witness. I am informed and believe, and based upon an affidavit of Hernandez alleged that he was told not to make any statements or give any information to my lawyers or to me, and he was told not to be available for any statements or to say anything. I am informed and

believe and therefore allege that Hernandez, who was present at all times that Cantu talked to me, would have testified that Cantu made no such statements to me.

That subsequent to the trial Hernandez revealed the fact that he had been instructed during the trial not to talk to anyone and not to inform anyone what the facts were. That his evidence contradicting Cantu and corroborating me that Cantu never made representations that he wanted the narcotics for prostitutes was vital in my defense and was knowingly and wilfully suppressed through agents of the government, in violation of my constitutional rights to a fair trial under the due process clause of the Fifth Amendment to the Constitution of the United States.

/s/ BERNARD BLOCH.

Subscribed and sworn to before me this 7th day of February, 1954.

[Seal] /s/ MARGARET DODDS,
Notary Public in and for Said County and State.

[Endorsed]: Filed February 10, 1956.

[Title of District Court and Cause.]

AFFIDAVIT

United States of America,
District of Arizona—ss.

I, Robert S. Murlless, being hereunto duly authorized, of my own knowledge, upon my oath, depose and say:

Gilbert Hernandez was not secreted nor sequestered during trial as alleged in paragraph .... on page six of his affidavit filed in support of motion for new trial. I observed Gilbert Hernandez in open court on one of trial days during trial of this cause.

/s/ ROBERT S. MURLLESS.

Subscribed and sworn to before me this 13th day of February, 1956.

[Seal] /s/ WM. H. LOVELESS,
Clerk of the United States
District Court.

[Endorsed]: Filed February 13, 1956.

[Title of District Court and Cause.]

MINUTE ENTRY OF
MONDAY, FEBRUARY 13, 1956

The Mandate of United States Court of Appeals comes on regularly this day for approval and Defendant's Motion for New Trial, filed February 9,

1956, is called for hearing. Robert S. Murlless, Esq., Assistant United States Attorney, is present for the Government. The defendant is present in person with his counsel, Morris Lavine, Esq., and Robert Renaud, Esq.

Counsel for the Government moves that the Mandate be approved and spread on the minutes. Said motion is resisted by counsel for the defendant.

Defendant's Motion for New Trial is argued and submitted.

It Is Ordered that Defendant's Motion for New Trial is denied, and that the Mandate of the United States Court of Appeals be and it is approved, and that the same be spread upon the minutes.

Counsel for the defendant moves for order fixing bail pending appeal.

It Is Ordered that said motion for Bail Pending Appeal is denied.

Counsel for the Government moves that defendant be remanded to the custody of the Marshal.

It Is Ordered that the defendant be and he is committed to the custody of the United States Marshal for execution of the judgment and sentence imposed on July 6, 1954, and that the defendant's bail bond pending appeal heretofore, filed on July 6, 1954, is exonerated.

(Docketed Feb. 13, 1956.)

C-12340 Phx.

United States of America—ss.

The President of the United States of America

To the Honorable, the Judges of the United States District Court for the District of Arizona, Greeting:

Whereas, lately in the United States District Court for the District of Arizona, before you or some of you, in a cause between United States of America, Plaintiff, and Bernard Bloch, Defendant, No. C-12340 Phx., a Judgment was duly filed on the 6th day of July, 1954; which said Judgment is of record and fully set out in said cause in the office of the Clerk of the said District Court, to which record reference is hereby made and the same is hereby expressly made a part hereof,

And Whereas, the said Bernard Bloch appealed to this court as by the inspection of the transcript of the record of the said District Court, which was brought into the United States Court of Appeals for the Ninth Circuit by virtue of an appeal agreeably to the Act of Congress, in such cases made and provided, fully and at large appears.

And Whereas, on the 23rd day of September, in the year of our Lord, one thousand nine hundred and fifty-five, the said cause came on to be heard before the said United States Court of Appeals for

the Ninth Circuit, on the said transcript of record, and was duly submitted:

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be, and hereby is, affirmed.

(October 12, 1955.)

You, Therefore, Are Hereby Commanded that such proceedings be had in said cause, in conformity with the opinion and judgment of this court, as according to right and justice, and the laws of the United States, ought to be had, the said appeal notwithstanding.

Witness the Honorable Earl Warren, Chief Justice of the United States, the twenty-third day of January in the year of our Lord one thousand nine hundred and fifty-six.

/s/ PAUL P. O'BRIEN,
Clerk, United States Court of Appeals for the Ninth Circuit.

[Endorsed]: Filed February 13, 1956.

[Title of District Court and Cause.]

ORDER DENYING BAIL

A motion having been duly made on February 13, 1956, for bail pending appeal from the order denying a new trial and refusing to vacate the judgments

on Counts I, II, IV, V, VII and VIII, entered on May 27, 1954, and the court having doubt as to his authority to grant the motion for a new trial at this time, the court denies the application for bail pending appeal.

Dated this 13th day of February, 1956.

/s/ DAVE W. LING,
Judge.

Receipt of copy acknowledged.

[Endorsed]: Filed February 13, 1956.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Offense: Violation of Title 26 U.S.C. 2554(a). Sale of narcotics not pursuant to written order form and not pursuant to lawful business nor legitimate practice of profession (six counts).

Verdict of guilty as to Counts I, II, IV, V, VII and VIII on May 27, 1954, and Judgment of Conviction entered on May 27, 1954.

Order denying Motion for New Trial February 13, 1956, under Rule 33, Rules of Criminal Procedure, after return of mandate.

Judgment of two years' sentence made and entered July 6, 1954.

The above-named Appellant does hereby appeal to the United States Court of Appeals for the Ninth

Circuit, from the above-stated judgments and orders.

Dated this 13th day of February, 1956.

MORRIS LAVINE,

/s/ MORRIS LAVINE,

McKESSON & RENAUD,

By /s/ ROBERT H. RENAUD,
Attorneys for Appellant.

Receipt of copy acknowledged.

[Endorsed]: Filed February 13, 1956.

In the United States District Court for the District of Arizona

No. C-12,340 Phoenix

UNITED STATES OF AMERICA,
Plaintiff,

vs.

BERNARD BLOCH,
Defendant.

Thursday, May 27, 1954—Ten o'Clock A.M.

Before: Honorable Dave W. Ling, Judge, and a Jury.

PROCEEDINGS

The Court: You may proceed with your arguments.

OPENING ARGUMENT FOR PLAINTIFF

By Mr. Murlless:

If your Honor please, counsel for the Defendant, ladies and gentlemen.

This matter has taken some two days already, and it is not my purpose to thrash out every word that was said again. It would take too long, and it is not, in my humble opinion, it is not an economical use of your time.

As a matter of fact, I don't know which part of the case isn't pretty obvious, but it comes the time in the trial when opportunity is given to what they call argue the matter, and I shall take to some degree a short period of your time for my turn.

It is not so much argument, it was not my estate, if you will recall, in the opening statement, to start with an argument either. It may be the most significant thing that was said at that time, was this: I have here a copy of the indictment, a copy of the original that is on file. If you will recall, we went non sequitur, it seemed like it was kind of a fruitless thing. The Clerk had already read the nomination of the case, the name of the case, and we talked about [2*] it again very briefly.

It reads, if you will notice, United States of America versus Bernard Bloch. It is not United States of America versus Gilbert Hernandez. It is not United States of America versus Renaldo S. Cantu. It is not against Pat Ross, not against anybody except Bernard Bloch.

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

And it has been that kind of a dust storm, one or the other of that kind of a dust storm that has taken your time, most of your time for two full days.

And it started right away in the opening statement that followed mine. The dust clouds were begun to be stored up, and most of our time has been waiting for the dust to settle, and to settle the clouds, and confusion has been generated, and to let it settle out so we could see what happened. And when you look at what generally was testified to, as I say, I have only my own opinion. It seems like what happened in this case, however, is pretty obvious.

And then we talked about each one of the allegations of the indictment, and it was pretty dry talk. It was not very much of a display. It didn't sound very smart, and it didn't make, it was a series of things, like there was a sale of narcotic drugs not in the course of a medical practice, not pursuant to a [3] treasury form, a form provided by the Secretary of the Treasury for the person to whom such drugs can be sold, or may be sold under law.

It was not pursuant to a prescription, and it happened the first time, if you will recall, we went through the September 24th, the 29th day of October, the 30th day of October, the 16th day of November, and the 19th day of November, all of 1953, and it didn't sound, it didn't make much difference anyway.

The most important part was, the case legend has

been, even when the dust clouds were being stirred up, it was United States of America versus Bernard Bloch, and they endeavored to try everybody else.

Now this morning for just a short time, let us try just this one case. You are not expected to try three or four all under one charge, just the one case, United States of America versus Bernard Bloch.

I said, it seems to me pretty obvious what happened. When all of the smoke is cleared away, and the dust is settling, and the underbrush cut away from it, there is not much in issue here. But they do raise an issue. They have endeavored to show a defense. And what is it?

It is not my purpose to confuse. It is to cut all that that is not necessary, all that that was [4] just to confuse things, away from it.

What is it? In simplest terms, what they have tried to show is that these—I shouldn't say all of them, because they deny, of course, that some of them were ever sold, but the first one mentioned in the indictment, which is Government's Exhibit 4-A in evidence, and the last of the narcotic exhibits, which is Government's Exhibit 9-A in evidence, those are the ones they admit were sold.

They say we didn't do anything else, but these were sold in the course of a medical practice.

"In the course of medical practice." The Government contends, I urge you, that the evidence that you can believe from the stand here has shown that even these weren't connected reasonably, within reason, to a professional medical practice.

Look at them. First thing, look at them. And this bothered the Defendant on the stand, that they did not look to be.

The only sticker they have on exhibit 9-A is one obviously that the government agents put on there to identify it.

Look at 9-A. What does it contain? Everything that the government agents have put there, and what you observed put there this morning. Forget about [5] the record that was made. What is that?

The admission is it is a deadly poison, or two of them. That is what it contained, is two deadly poisons.

It looks like water in a non-labeled bottle. Deadly. They say it is deadly.

Does it look like it came out of the regular course of a medical practice? Not labeled. Not anything.

Look at Exhibit 4-A. This is the one that was a dirty bottle in the first place. It stinks. Is there anything about that that looks like the course of a medical practice?

The government agent put that there, and that is where his initials were. And you see how carefully government agents handle this stuff, and how it gets identified time and time again, and how it takes a bundle of paper—this was done with respect to Government's Exhibit 3 in evidence. It takes a bundle of paper to get one of them in evidence. They wrap it in paper and put it in an envelope that it takes him minutes to get it out of.

It is dangerous stuff. They don't deny it. A deadly poison, they say, mixed with another deadly

poison, and they handle it, and it is handled in a [6] manner that looks like water. And they say "in the course of a professional medical practice."

It is not. I leave it to you ladies and gentlemen. If it is in the course of anything, it is in the course of the narcotics traffic.

And what do they say about Government's Exhibit 9-A there, and I don't mean to misquote or misstate. Particularly, I think it is 9-A that contains —the testimony was it contains 30 cc., and rather than misquote it—I am wrong, it contains 20 cc., the testimony from Mr. Hubach was. This is 20 cc.

Defendant stated that he got 30 cc. of morphine sulphate and atropine solution, 30 cc. for about a dollar. And what he sold it for, 9-A, was $50. Fifty dollars. Bought it for—this is two-thirds of what he could purchase for a dollar. Sold it for $50.

In the course of a medical practice? I say to you, ladies and gentlemen, no. In the course of the narcotic traffic.

What does it look like? It doesn't look like a doctor's medicine bottle to me. It looks like it has got water in it. No identification. It took all this paper and all the time of these agents to show you what is in that exhibit, that Government's Exhibit 9-A.

Those are the ones he admits. He says the [7] others are a mistake. He didn't do it, didn't have anything to do with it.

And the first one was Government's Exhibit 3, which isn't in the indictment. It was that which occurred the day before the first allegation here. The first allegation here is that of the 24th day of

September, 1953. It is not here. This is the first one, Government's Exhibit 4-A, is the one that was handled on the 24th of September, that they admit was.

5-A, 6-A, 7-A and 8-A. One of them, ladies and gentlemen, with an identifying label on it. One of them labeled, with an identifying label on it, one of them.

Government's Exhibit 6-A. One of them with an identifying label on it. This is the one, too, which could be concretely identified by its own self. You could show what it was on the outside of it, and what doctor said that this was a treatment, a good treatment for narcotic addiction? None of them. It is not. None of them. And there is one that is missing there.

We had a lot of talk about morphine mixed with atropine, as one counteracts the other, so they don't satisfy a narcotic's desires. But there is one that is not morphine sulphate and atropine combined. And what is it? [8]

Dilaudid. One of the most powerful of the drugs. C. E. Hubach says, just like morphine, a derivative of opium, and within the violation that is described in hundreds of pages of Title Twenty-six, United States Code, dedicated to the control of the vicious deadly traffic in narcotic drugs. Dilaudid. I don't say he didn't have an explanation for this. He almost had an explanation for everything, almost for everything.

This, he didn't buy it from me. They took it off my shelf the day eight agents were out there and

swarmed all over the place. A number of people went through my cabinets, went through my office, all over the place. They didn't find a card, obviously, that would, or they urge now will explain everything.

I asked him about it again later. He didn't know about it then either.

Look at Defendant's Exhibit B. It looks like it was written all at the same time, just like Mrs. Woods.

I felt sorry for her, the nurse that made the entries. She was told what to say, just like she had to say it, and she admitted, yes, it looks to me like all of the entries in Defendant's Exhibit B in evidence that read "Raymond Portillo, or Portillo, by Raymond, [9] were made in the same color ink. You look at them, ladies and gentlemen. They are only a different shade of the color right above them, but you look at each one of them. That is right, they are.

All of them are made at the bottom of the column in which they appear, concidentally made in just a little different color ink than those above. All of them made in a place where they could have been made at a different time than what they represent.

All of them, the only entry of its kind, that is, one person paying for another. The only entry of its kind in the book, those four, all with respect to the same two names.

It is almost endless, the reiteration that I could go ahead with, and I am like you, I think enough

is enough, when it is clear, and when the dust is settled, and it is plain that we should stop the argument and stop the talk.

It doesn't look like the medical practice to me. It looks like the narcotics traffic.

Look at them, ladies and gentlemen.

ARGUMENT FOR DEFENDANT

By Mr. Church:

Your Honor, ladies and gentlemen of [10] the jury, Mr. Murlless.

Counsel for the Defendant has started out saying that there had been a tremendous dust storm created to try to becloud these issues. He said the dust storm was created by a Mr. Cantu, and a Mr. Hernandez, both of whom are paid agents in their employ, by all of the uncontested testimony in this particular case.

If there is any dust storm stirred up by those two men, it certainly isn't the fault of the defendant. Those are the paid employees of the Government that have stirred up the storm.

Now, our purpose at this time, and I do want to take a little of your time, because this is a deadly serious thing. It is a very serious and heinous crime that is charged against my client.

At this time, you are probably in the position of working on a jigsaw puzzle, where you have lots of bits of evidence in different shapes and yet they aren't related or put together so you can see what

the total picture is, and how the facts are related to the law in this particular case.

You have been reminded, and you will be reminded again, that you are the sole judges of the facts, what happened and the credibility of the witnesses. [11]

You watch the witnesses. You determine whether in your opinion you think they are telling the truth. You are the sole judges.

The judge will instruct you with reference to the law, and how you apply the law to this particular case.

I must remined you again that this is a criminal trial. Now, in a civil trial, you only have to prove by a preponderance of the evidence each of the material allegations made, but in this case, a criminal case where the consequences are so great, the government must prove beyond a reasonable doubt every one of the material allegations that are set out in their charges which he read to you.

Now, let us look for a moment at these charges.

In the first place, I want to point out, as you no doubt heard when this trial opened, that count III and count VI charged Dr. Bloch with unlawfully, unduly and feloniously obtaining certain narcotic drugs by means of order forms, and so forth. Those two charges were dismissed at the instance of the government, because they couldn't prove them.

So, therefore, the Court will instruct you that counts III and VI are out. [12]

In other words, there is no evidence even by the admission of the government that any of these drugs

were obtained either from retail, wholesale sources, or in any other manner, in an illegal manner. They, by their own stipulation before you, they stated there is no question about that, and they have asked for a dismissal of those two counts, and they were dismissed.

Now, let us look at the wording of this charge, and all of these counts read the same.

That Dr. Bernard Bloch on a certain date, the dates which you have heard, did knowingly, willingly, fraudulently, and feloniously sell to one agent, or one R. S. Cantu a certain quantity of narcotics here.

Now, I want to be perfectly honest with you folks. I don't think that Mr. Murlless made a fair statement in his own behalf with reference to these particular exhibits. We didn't deny giving any of those, with the exception of these two dilaudid tablets, which we stated were taken out of the car by an agent.

Now, Mr. Murlless says there is only two. I want to be perfectly fair with him. We admit that all of those were given in the ordinary course of Dr. Bloch's practice to a person whom he thought was a patient.

Let us get the record straight, and let us be fair about this. We admit all of them were given, with [13] the exception of these two dilaudid tablets, and may I point out in that connection that the government has never shown what the quantity of dilaudid is in those tablets. They could be absolutely harmless.

With reference to the morphine, they pointed out the quantity, a quarter grain, a sixteenth of a grain, an eighth, and so forth.

That is the only way you can tell whether or not they are dangerous.

Now, the government has to prove beyond any reasonable doubt in the minds of any one of you jurors that Dr. Bloch knowingly, willfully, fraudulently, and feloniously sold these drugs to one R. S. Cantu, and not in the course of a professional practice as a physician, and not to one whom he believed to be a patient.

Now, a doctor can prescribe. They are giving an acutal prescription if they do it in good faith, and in the ordinary course of practice.

The Judge will so instruct. There is nothing wrong with that. That has to be. That is what a doctor's business is, and if he does it in good faith, and if he does it in the course of his ordinary practice, then he is guilty of no crime whatsoever, and you will have the instruction of the Court with reference to that.

Now, all these counts are similarly worded, [14] and the only difference in the counts is a breakdown to show different transactions over a period of time.

Now, what is the evidence, ladies and gentlemen? According to Mr. Ross, whom you heard testify, who is the head of the Phoenix Narcotics Bureau, Dr. Bloch had been under the closest scrutiny, under investigation by their Narcotics Division for nearly three years. They had one Hernandez who was being

treated regularly by the doctor, and in their employ, and pay of the Government, who was receiving regular treatment from Dr. Bloch for nearly three years.

Now, you can imagine at the use of a man like Cantu the methods that were used. How many Cantus, who knows. But we do know by their own statements that they tried for nearly three solid years to find one violation of the Narcotics Act by Dr. Bloch, and they couldn't find one with reference to any of those patients.

They used all the methods that the Government has, which are many and devious and competent, and I think they should have those resources at their command, but they tried for nearly three years to find one patient that Dr. Bloch had treated improperly with reference to narcotics.

Mr. Ross says even his predecessor Smith, who [15] was the head of the Bureau, had him under investigation. Mr. Smith died in the service, but when he died, as a result of his investigations, there was not one iota, or one instance that the Government could point out where Dr. Bloch had violated the provisions of the Narcotic Act.

Now, think of what this means. The evidence is uncontroverted that Dr. Bloch sees between 25 and 30 patients a day. His book will show that that is almost 9,000 consultations, not all the same patients, in a year. Over a period of three years, it would be over 25,000, and yet in all of this time the Government by their own admission had him under obser-

vation trying to find out through Hernandez, yes, a known narcotic addict being treated by Dr. Bloch, and Hernandez, you can imagine, in every way possible trying to get a little extra drugs here, a little extra drugs there, naturally they are trying to find out whether he is violating, but try as they would, for nearly three solid years, there was nothing. I wonder if any of us were under investigation for three solid years, such as that by a very competent government service, one of the most competent, I am wondering if we could make as good a record as Dr. Bloch made.

And then what did they do? They finally [16] found out that they couldn't find it on a patient, so they put a plant in there in the name of one Cantu.

Now, let us look for a moment at the story of Mr. Cantu. He comes into the office of Dr. Bloch with a man by the name of Hernandez, who purports to be his brother.

Now, in fairness to Mr. Cantu, he said that he didn't say or tell Dr. Bloch that he was his brother, but he did say that Hernandez told him he was his brother, in his presence. He never said anything, so he led him to believe that he was his brother, this brother of the known addict, and addict that the Government knew was an addict, and an addict in the employ of the Government trying to get a violation.

So he introduces himself or leads Dr. Bloch to believe that he is the brother. The testimony is of his secretary that he did tell him he was his brother.

He said that Hernandez stated he was his brother,

and he didn't say anything, so I think it can be assumed that he posed as his brother.

Now, there is some question as to what else he posed as. I don't think that makes any difference. I don't think it makes any difference, as the paper said today. I am sorry to see some of the things tried in the paper, as to whether or not he would make a great [17] actor, or anything like that. That isn't important, because it is too serious for any levity such as that.

He said himself that he had three prostitutes that wanted the drug, because they were addicts.

Dr. Bloch states that he presented himself and showed the very symptoms of a narcotic addict, and Dr. Bloch states that in good faith he treated this man, thinking he was a patient.

Now, there is a conflict in the testimony. I am wondering if you noticed, any you are the judges of the facts, did you notice when Mr. Cantu was on the stand, I couldn't help but notice, he sniffled every once in a while, and he pulled his handkerchief out and wiped his hands, which is one of the symptoms, as the doctor said, the clammy hands, the sniffling. You know, when you do a thing so long, it almost becomes part of your subconscious. And I was very interested. I don't know how many of you saw that or not, but the statement of Dr. Bloch's testimony is that he complained of these stomach cramps, that he presented this evidence of sniffling that a known addict presents. You will note the testimony of Mrs. Woods, the secretary, that he was nervous, he changed from one chair to the

other, and he appeared to be nervous and agitated, as an addict would be. [18]

Now, I am going to give Mr. Cantu full credit for being a fine actor. I am telling you this, he wouldn't stay in the employ of the Federal Government as an undercover agent for very long unless he was a fine actor. He couldn't do it unless he was a fine actor, so he could pretend he was an addict and get something he shouldn't get.

I don't know whether he represented himself as a great lover boy, and all that business. I don't think it makes any difference in this particular case.

Here we have a man of the name of Hernandez, David, and incidentally, David Hernandez is a known addict. The testimony shows he is known by the name of Portillo. He also goes by the name of Yung. And I don't know how you feel about it, but I am always suspicious of a person that goes under a number of names. He is usually trying to hide something, unless it is legally changed, of course. But when a person goes under two or three types of names, it is for the purpose of deception, what kind of deception we don't know. In this particular case, I think we do, to attempt to secure something on the particular doctor.

Now, I want to point out with reference to Hernandez, now, this is David Portillo Hernandez, who was a known addict, and was treated by the doctor. The [19] evidence shows he did owe a doctor bill. He didn't pay the bill, and he was charged over two or three years that he was treated, and he built up a bill, and he didn't pay the bill.

Another thing, Dr. Bloch testified, and it is uncontroverted, that David Hernandez got the same kind of treatment, the morphine-atropine treatment that was given to Mr. Cantu.

The Government knew about this treatment of Hernandez. They had been watching him. He is in their pay. They have condoned this treatment all along as a treatment, as the prosecutor has suggested, instead of a treat. They knew that this type of medication was given to the known addict. They didn't disapprove, and yet they take the same kind of treatment and try to make a federal case out of it.

Now, apparently the Government just grew weary of trying to find Dr. Bloch in any slip-up with reference to any narcotics, so they did put Mr. Cantu in the picture.

Now, he also, you notice, did what a fellow who is doing his job in that particular connection should do. I am not quarreling with him. He tried to get other things. He tried to get dilaudid, but you notice with reference to dilaudid, every time he tried [20] to get that, did you notice he never ordered it, he never got them. The only thing he got were these.

(Indicating exhibits.)

Now, he says, the distinguished prosecutor here says that he bought something for a dollar and sold it for fifty dollars. I think the testimony is apparently uncontroverted, insofar as I can remember —maybe you can remember better than I can—that this money was applied on these particular bills of the man that already owed the doctor money. You

heard the testimony of Dr. Meyers, who was the very experienced man in this field, as to the type of money that is charged for the treatment of a narcotic addict, $1,000 to $2,500.

A professional man doesn't sell merchandise. He sells his time, and that time is very valuable. As the doctor said, I think it was $30 to $35 an hour, something like that. That is what a professional man has to sell. He is not selling merchandise. I mean, the fact he paid one dollar for it, he is selling his knowledge and his experience and his time. That is all he has to sell. A doctor and lawyer.

Now, you will note that each time Mr. Cantu spoke of receiving any of these exhibits, he always referred to it as medicine. You notice that he always [21] said he asked Dr. Bloch for some more medicine. Medicine. Well, medicine connotes a treatment, not anything that would satisfy the craving of a known addict. He by his own phraseology says that he was after medicine.

Now, I was very surprised. Let us look at what was given when Mr. Murlless said no doctor said it was a treatment.

Both doctors said it was a treatment. I went over one by one with Dr. Myers, and then his own doctor said yes, that would be a treatment, and I asked him, now, the presence of atropine in a solution such as this, I put the question directly to him, and they both said it was a treatment, yes, that would be a treatment.

And the presence of atropine is an element, as is

testified, and, incidentally, I mean when we come in here and talk about these as being water, or something like that, well, laymen don't know what are in these particular bottles. That is why we have to have the expert witnesses, and doctors, and chemists to tell us what that was. That might be a particular type of atomic energy that might be devastating. How do we know? That is why we have the expert witnesses, and the expert witnesses said these were treatments, that all these, even if taken all at once, couldn't [22] satisfy the craving of an addict.

Mr. Ross says it takes one and one-half to two and one-half grains a day to satisfy an addict. On the average here, over the 56 days that Mr. Cantu secured this particular medication, is averaged 1/16th of a grain, if he took them gradually, 1/16th of a grain a day over the 56-day period, and then it had the presence of atropine, which both doctors said was a method of treatment.

Now, as a matter of fairness, the doctor says it might have been a clinical mistake. Both doctors believe, and I think they are probably right, that he should put an addict in the hospital. But you know most of us are plain folks. We can't raise $1,000 to $2,500 for treatment.

I don't believe there are any methods of treatment, even in the Veterans Administration, for addicts, according to the testimony there, and that a thousand to $2,500, as was evidenced or brought out on the witness stand, is only for the medical bill. You have to pay the hospital bill too.

Yes, it would be a very desirable thing to hos-

pitalize people, and Dr. Bloch said he intended to hospitalize this man, suggested that he go to the hospital. [23]

Now, in fairness to Mr. Cantu, he denied that. That is a question of who to believe on that particular set-up.

Sure, it might have been a clinical mistake, but if a doctor—I mean a clinical mistake in that he didn't send him to the hospital, but if a doctor in the ordinary course of his practice, if he is dealing with one whom he thinks is a patient, has a right to prescribe a given medication, whether it is labeled or not labeled, for that particular ailment, or to relieve suffering, and the Judge will so instruct you when it comes time for that.

David Hernandez strikes me as a very interesting person. David Hernandez was an employee of the Federal Government, treated by Dr. Bloch for nearly two years. I wonder why they didn't bring him to the stand. He could have explained, maybe, a lot of things, or maybe we could have asked him certain questions. I wonder why they didn't bring this very important witness with reference to what happened to the stand.

He is their employee. He knew quite a bit about this. Apparently he was the one that introduced Cantu. I am just wondering why they didn't bring him.

Mr. Murlless didn't make any mention of the patient's card. There was a patient's card. There is [24] some question as to whether or not the agents that did swarm, I believe you will find from the evidence, through the offices, whether or not

they did pick up this particular card. It is in his handwriting. He testified he made these entries at the time.

He testified that on particular patients, it is reasonable, all the doctors do it, if there is a serious disease, if there is even tuberculosis, even cancer many people feel cancer is something they don't want anybody to know they have, not even their secretaries, so doctors do keep confidential files in their offices so nobody will know, and it is strictly a confidential relationship between that patient and the doctor.

What more normal than that this card should be on his desk? I don't think Dr. Bloch can be charged with pointing out everything. Of course he was scared. He told him he thought it was a dirty trick, and I believe it was a dirty trick, too, the way they tried to entrap this man into committing a violation of the law. Sure, you would be nervous, too, if six or seven, at least there were five, swarm in on your place of business and say you are under arrest, no warrant of arrest, not even a search warrant do they get.

And the Judge will give an instruction on that. [25]

Now, there is much ado——

The Court: On what. The Judge will give an instruction on what?

Mr. Church: On search and seizure.

The Court: Oh, well, I denied your motion to suppress.

Mr. Church: Excuse me. I didn't know whether he was going to give that or not.

Now, with reference to these office records, there was much time spent. But the doctor, with his confidential cards, I think it was explained, he gave these cards at the end of the day to the girl, but the important thing about the office records is what in the world they had to do with the material allegations charged here. They don't have one thing to do with whether or not he was feloniously selling narcotics not in the course of practice. Not a thing to do with it. That is one little dust storm I think could be left out.

Now, with reference to his analysis of the particular exhibits, he holds up a bottle and says, "It is deadly poison." That is not what the evidence said. I think the doctor said, you will recall, that if it is taken in excessive amounts, the atropine, it is a poison, and the reason that it is mixed with morphine [26] is to try to discourage the use of morphine. And it is a poison, but only when taken in excessive amounts, and the doctor testified they couldn't possibly take all this at once. It would make them deathly sick, and that is why the atropine is added to that particular solution.

Now, I think one of these bottles, he said the bottle stinks. I think that is the bottle that smelled like vitamins. I think the testimony showed Cantu carried one of them around in his pocket for two days, if I recall the testimony correctly. I don't know if it makes any difference.

Now, as I say, we feel that this doctor, in the

ordinary course of his practice, and this is very important, you are going to have to decide whether or not Dr. Bloch in good faith, to a person whom he thought to be a patient, administered drugs for the relief of suffering, or to cater to an ailment, or a craving, in the course of his employment.

Now, Cantu, every time Cantu came up there he didn't go any place else, except in a doctor's office. Isn't that where a patient goes, unless a doctor goes out on a house call, and when he got up there, I imagine he was rather impatient, and they made him wait just like any other patient, with one exception. I [27] think they said there was only one in the office one time, and he was ushered in. He was treated as a patient. A card was made out for him as a patient in the course of the medical practice.

Here is a busy doctor, 25 or 30 patients a day, and taking him in turn, and him waiting around, Cantu waiting and shifting from chair to chair, nervous, in the course of his practice.

Did he do it in good faith? There is no controverting of the statement that Dr. Bloch never knew that Cantu was a Government agent until on that day on the 19th of November he presented himself and said, "You are under arrest."

I think we all believe that. Did he in good faith think this man was a patient, administering this to him which both doctors said are treatments. I believe he did, I believe he did it in good faith, and I certainly believe he did it in the course of his practice, because if he had had any desire to slip any of this morphine-atropine solution, or anything that

would cater to the craving of an addict to them, he probably slipped it out a side door, or met him some place. He doesn't even act like a person who is dealing in the traffic of morphine. That is not the type of person that the law says violates this particular act. [28]

The law says, and the Judge will so instruct, that if this doctor in good faith, in the course of his medical practice, administered these to a person whom he thought to be a patient, then there is no violation of this law, and that is as it should be.

A doctor under the oath of Hippocrates, that every doctor has to take, makes a solemn pledge, and it is incumbent upon him to treat and relieve human suffering, physical and mental.

That is his duty. He has to do it. He has to make a decision, and if he does it in good faith, and he does it for a person whom he thinks is a patient, and in the course of medical practice, he is not guilty of any crime under this Act, and you will be so instructed.

If that is so, there is not a doctor in the United States that couldn't be held guilty under this particular Act. And it would be a terrible devastating thing to contemplate.

Therefore, ladies and gentlemen of the jury, I think the Government really found out whether this Dr. Bloch was one who was prone or even inclined to violate the Narcotics Bureau Act. It took their staff and watched him for nearly three years, and they never found one patient out of all those thousands of patients [29] that ran through Dr.

Bloch's office, not one instance did they come up with where he had violated, and so they tried to entrap him.

Now, entrapment.

Even if he were guilty of it, even if this were an improper administration of this particular drug, if the Government entrapped him into committing the crime, then there is a perfect defense there for the Defendant, because if the intent to commit the crime originates in the mind of a Government Agent, and not in the mind of the Defendant, in other words, if the defendant is put in a situation where he will violate the law, and that intention originated with the Government, there is no crime committed under this Act, and that is perfectly proper, because no private citizen should be subject to an entrapment where that desire, or the intent, the guilty intent which you must show in a criminal case originates with a Government Agent, and not with the Defendant.

I think clearly in this case that the intent to violate, the intent to manufacture a violation of this law, originated with the Government Agent and not with Dr. Bloch.

I believe that he in good faith administered a treatment to a person whom he thought was a narcotic [30] addict, or represented himself as an addict, for either the treatment of that or the relief of suffering of that particular man.

And, ladies and gentlemen of the jury, I believe that you will agree with me.

Thank you.

The Court: We will have our morning recess at this time. Keep in mind the Court's admonition.

(The morning recess was taken.)

The Court: You may proceed.

CLOSING ARGUMENT FOR PLAINTIFF

By Mr. Murlless:

I still think that this is not in the regular course of a medical practice. These series of exhibits are the regular course, if anything, of the narcotic traffic.

But we ran the gamut again. Everybody lined up and prosecuted, except the Defendant Bernard Bloch.

As I said before, we can go over it again back through every bit of it and show why it is smoke screen, and not significant, not important.

They added a new name to those that should be prosecuted in this case, and it was my turn. I figured it was going to be. I didn't know Hernandez. I didn't know Gilbert Hernandez. He is not my patient. I didn't [31] put Gilbert Hernandez where he is today, with the burden on him, with the use of morphine sulphate, a deadly poison, and I am not perpetuating the dope habit amongst known narcotic addicts. The Defendant did, this man.

I don't assume the responsibility for Gilbert Hernandez.

He says himself he treated him for two years to cure his addiction. No, at a thousand per cent on

his money, that he paid out for morphine sulphate. It figures out that way. I didn't do it. I am not responsible for the sickness that Hernandez has. That is what I am saying. That is all the Government has said. And this Defendant in the narcotics traffic.

I got tried some other way, too. I think it was with respect to Defendant's Exhibit A, but I did talk about this. I said it appears to have been written all at the same time, and I leave it to the dust.

I talked to you about it, but look at it again. He talks about good faith. Where is there a medical record of Raymond Portillo on that card? Entries of appearances. No medical record. Not an address, not his family. In the course of a medical practice, I say to you no. Like this stuff, poison without labels.

Who else did we try? Didn't prove counts [32] III and VI. That is right, we didn't, but he didn't read those, and they testified why they couldn't be proved. He didn't read you the part that made it impossible reasonably to expect to prove it, because it says that on or about the 30th day of October, such and such was done with forms, the obtaining of drugs for other than their proper purpose. Because we didn't establish within a reasonable period of the 30th day of October. It was testified to. Yes, we requested that it be dismissed. We couldn't prove it.

Then they tried the Government. For three years, he says, nobody else. He says it, nobody else says it, counsel testifies about it. The Government has

been trying to get this man. Had complaints been made against the Defendant Bernard Bloch other than these, and did they go back for a period before, and was he under investigation? The making of a complaint, or the making of a file constitutes the commencement of an investigation. And more than that, Mr. Ross took the trouble to go get the stuff that he had been requested to testify on from hearsay, and came back to court the next day, and says, "Now I am ready. I will be specific about it, about what complaints were made." And of course they don't want to talk about that. They stopped right now. [33]

These solutions, the next smoke cloud, dust cloud, these solutions wouldn't satisfy a narcotic addict. And Mr. Ross is quoted. How does he know, only from his practical experience in the Government service. And he did say that two grains might be required to satisfy—two grains a day to satisfy a narcotic addict, and he is broadly quoted as indicating that these wouldn't do it.

The same kind of thing was said about Government's Exhibit 6-A during the testimony. It was to the effect that this has a quarter grain per ounce. It is not labeled. It reads. "a quarter grain per cc., a quarter grain of morphine sulphate per cc."

As the testimony came from the stand, it takes 29 cc.'s to make a liquid ounce.

I don't know what they said, and I won't try to state it, because I don't know what the testimony was was a usual dose by injection.

The testimony was that this constitutes approximately one cc.

And I should warn you about that, too. This one isn't the one that smells, but it doesn't appear to be really tightly sealed, so maybe it is not quite a cc. I don't know how much they put in a syringe, but it looks like it might be. This contains a quarter grain. [34] It would take eight grains to be two cc., if they want to quote Mr. Ross.

Another part of the smoke screen, it could be done easily within a day.

And we are back again to 5. No, he changed it to 5 this time, and not 8 agents swarmed out there.

You see, that is the way all the way through. Just take time off. Take all of your time for the rest of the day, and maybe answer all the little inflections that constitute their serious objections to the way the case has been prosecuted, and it got to be my turn to be Plaintiff in this matter.

They don't look like things purchased in the regular course of a medical practice. They look like matters that were purchased in the narcotics traffic. Look at them.

Item number one, that is the first of the things that were testified to. Government's Exhibit 3 is one cc., contained, the testimony was, one cc.

Government's Exhibit 4-A, as I recall it, contains ten cc., I think that was the testimony. And together the first two, then, constitute eleven cc. That is right, eleven cc., the first two.

Government's Exhibit 5-A again contains ten cc. That makes 21 cc. of morphine sulphate. [35]

There is other matter there, too. But the first three, 21 cc. Government's Exhibit 6-A was 30 cc. of morphine sulphate. And that makes 51 cc.

There was in connection with 6-A dilaudid, too, but let us talk about morphine sulphate here. And altogether that is 51 cc.

Government's Exhibits 7 and 8 together constituted 40 cc. It came in two pieces, if you will recall. One a 30 cc. lot and, and then a 10 cc. lot in addition to that, that was handed to him the next day.

No examination on any of them, but this one he walked through the office and handed it to the agent, 10 cc.

And the last of the items was the one that was bought with the 50 dollars of marked money. It was twenty cc.

Altogether of morphine sulphate, about 101 cc. purchased by the statement of the Defendant himself, at the rate of about $1 per 30 cc., $3 worth of morphine sulphate. And for the morphine sulphate was paid $235. $235.

Now, ladies and gentlemen, there is one thing they didn't accuse Mr. Cantu of. They didn't accuse him of wanting to lose his job. I don't know how he struck [36] you, but he struck me as a man, for some time he has appeared to be a man who doesn't want to lose his job. They admit somebody, somebody in the case lied. But they don't accuse Mr. Cantu of wanting to lose his job. They don't accuse him: If he had falsified the figure $235, or where he was upon the days that it was stated here, if he had falsified any of that. He stated to you those reports were made under oath. He would lose his

job. And even they don't accuse him of wanting to do that.

That is what was paid, $235, which I calculated roughly as something in excess of 1000% upon the investment, not in the medical practice, ladies and gentlemen; in the narcotics traffic.

Thank you.

(Which concluded arguments of counsel to the jury of the trial of this case.)

I certify that the foregoing is a true and correct transcript of proceedings had in the above-entitled cause on the date specified herein, and that said transcript is a true and correct transcription of my stenographic notes.

Dated at Phoenix, Arizona, this 29th day of February, A. D. 1956.

/s/ JANE HORSWELL,
Official Reporter.

[Endorsed]: Filed February 29, 1956.

In the United States District Court for the District of Arizona

No. C-12340-Phx.

UNITED STATES OF AMERICA,

Plaintiff,

vs.

BERNARD BLOCH,

Defendant.

PROCEEDINGS UPON DEFENDANT'S MOTION FOR NEW TRIAL

Transcript of Proceedings had in above-entitled case before the Honorable Dave W. Ling, Judge of said Court, upon Defendant's Motion for New Trial, in the courtroom in the United States Court House, at Phoenix, Arizona, on the 13th day of February, A.D. 1956, at 11 o'clock a.m.

PROCEEDINGS

The Clerk: C-12340 Phoenix; United States of America versus Bernard Bloch. For approval of Mandate of U. S. Court of Appeals, and Defendant's Motion for New Trial.

Mr. Murlless: Plaintiff is ready.

Mr. Lavine: Defendant is ready.

The Court: All right.

Mr. Murlless: The Mandate, we believe, is correct, your Honor, and should be spread on the record.

Mr. Lavine: We oppose approval of the Mandate, if your Honor please. There are matters

which we shall present on our Motion for New Trial, and we would like your Honor to withhold the ruling until after we argue our motion.

The Court: All right. I will hear your motion.

Mr. Lavine: May it please the Court. At this time Bernard Bloch moves for a new trial on all the grounds set forth in our written Notice of Motion and our written Motion filed with your Honor, and our Points and Authorities which we have set out in that motion.

We also ask your Honor to declare the judgments on each of the counts void, as being in violation of due process of law guaranteed by the Fifth Amendment to the Constitution of the United States, and upon the matters which I intend to present and have presented by affidavit.

As I have looked at your Honor's wall here, I was [2*] very much impressed with the motto that we often look at but perhaps seldom read: "Truth always rises above falsehood as oil rises above water."

The Court: Not always. I have sat here for twenty years now, and I know it doesn't.

Mr. Lavine: We will try to have it rise in this case, your Honor.

The Court: All right.

Mr. Lavine: If your Honor please, one of the grounds of our motion is that evidence which was in the possession of the prosecution was withheld from the defense, so that it could not be presented at the time of the trial.

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

Your Honor heard the evidence in this case, and the essence of the charges, and the essence of the proof of Officer Cantu was that he did not want these narcotics for himself, but for girls, for prostitutes whom he claimed were working for him. And that is shown by the record which was printed up; and it is referred to in various places, both on direct examination and on cross-examination. Pages 104 and 105, page 120 of the printed record, and page 132.

Now, in this matter Cantu stated that he had got this information from Hernandez, and that Hernandez was present when he had a conversation with the defendant, and heard the conversation about this matter of not having the narcotics for himself, but for prostitutes. [3]

Hernandez was also known as Mr. Portillo, spelled P-o-r-t-i-l-l-o, although Hernandez is his true name.

At that time Mr. Hernandez was under subpoena by the government. He at that time was in the employ of the government. He was being paid by the government, and they had him where they could produce him to corroborate the testimony, or not produce him.

And, furthermore, they not only had him, but counsel, who sought to interview Mr. Hernandez to determine the true facts of the matter, tried to get in touch with Mr. Hernandez, a counsel named Wade Church, who is known to your Honor, and instead of letting Hernandez tell him the facts, they tried to get Mr. Hernandez to entrap Mr. Church

into offering him, Hernandez, a bribe, which Mr. Church did not do.

Now, whatever reprehensibility there is to that kind of conduct when a lawyer is seeking information from a witness who is vital to the defense, is added to by the fact that they told Hernandez, in the uncontradicted affidavit before your Honor, not to disclose anything to defense counsel, and not to disclose what his testimony would be in relation to the government and the representations that Hernandez made.

This case rested, your Honor, upon the credibility of one or the other person. Either Cantu was telling the truth or he was lying. Either Dr. Bloch was telling the truth or he was lying. [4]

And we come right to the principle set forth in Gordon versus the United States in 344 United States at page 414, particularly at page 418, where the Supreme Court of the United States said:

> "The trial judge in his charge and the Court of Appeals in its opinion recognized that, where, as here, the Government's case may stand or fall on the jury's belief or disbelief of one witness, his credibility is subject to close scrutiny."

Now, in that case the Government had failed to produce statements of witnesses that were in its possession which would have contradicted the one witness produced by the Government. And in an opinion unanimously reversed by the United States Supreme Court, no dissents in this one, the Court held that the defendant was entitled to have the

information in the possession of the Government, and the Court quoted at length:

> "Despite some contrary holdings on which the courts below may have relied, we think their reasoning is outweighed by that of highly respectable authority in state and lower federal courts in support of the view that an accused is entitled to the production of such documents. Indeed, we would find it hard to withstand the force of Judge Cooley's observation in a similar situation that [5] 'The State has no interest in interposing any obstacle to the disclosure of the facts, unless it is interested in convicting accused parties on the testimony of untrustworthy persons.' "

Now, we have here a situation where evidence was in the possession of the Government. Had they put Mr. Hernandez on the stand—they were relying on Mr. Hernandez' presence, the officer testified about it—had they disclosed, or had they permitted disclosure to the defense in an interview which Mr. Church sought, in three interviews, I believe, which Mr. Church sought, at least one in which they tried to entrap him into saying something else instead of getting the facts, then all of the facts would have been before the jury, and the jury would have had not only the doctor's testimony, but the testimony of the other witness whom it was claimed heard the conversation, and who would have been able to have testified as set forth in the Hernandez affidavit before your Honor, that no such matter occurred, and

no such conversation occurred as represented by Mr. Cantu.

The affidavit before your Honor discloses that he was present, that he, Hernandez, was present at all times that Cantu was present, and that at no time was there anything stated by the said R. S. Cantu to the said Bernard Bloch, or to anyone, that the said R. S. Cantu was a peddler of narcotics. At no time was anything stated that the said R. S. Cantu, by [6] the said R. S. Cantu or anyone else, that said R. S. Cantu was in need of said narcotics for girls that were in his employ, namely, prostitutes.

So, if your Honor please, it would have directly contradicted Cantu and would have substantiated the testimony of Dr. Bloch and would have been on all fours with the holding in the Gordon case.

Now, in the case of Coates versus United States, 174 Federal Second at 959, we have a somewhat similar situation, in the United States Court of Appeals in the District of Columbia Circuit. There defense counsel had gone to find out about a robbery of which the defendant was charged. The robbery was supposed to have been in a crap game, and there was supposed to have been a $20 bill with blood on it. There was a police officer who had gone to the place where the robbery had occurred and had investigated the whole matter and found no evidence about any $20 bill there, and he would have corroborated the defendant's story.

The Court of Appeals for the District of Columbia held that that testimony which was not obtainable and was not furnished to the defense until

after the trial was over was newly discovered within the meaning of Rule 33, and they remanded the case for a new trial based upon that newly discovered evidence.

We think the case closely parallels, if it is not on [7] all fours with, the instant case, in which the evidence here was suppressed from the defense and his counsel, and wasn't obtainable until after the trial was over, and in fact some time subsequent to the trial, and was newly discovered within the meaning of the Rule.

So I assert respectfully, your Honor, that in respect to this one situation, this one witness against another, if the evidence is corroborated and available now to the defendant, it should be permitted, the defendant should be permitted to produce it and to produce it in a new trial.

There is another situation, your Honor, which is highly worthy of your Honor's consideration of this motion. During the course of the trial, the prosecutor asked the defendant if he had ever been convicted of a felony.

Your Honor will recall that six months before there was an income tax case involving a tax matter of a thousand dollars, and the defendant had been convicted, and the conviction went up on appeal. And at the time of the trial the appeal had not been acted upon in our busy Circuit Court of Appeals, so the defendant was then forced to answer truthfully, as he did, that he was convicted of a felony, but the case was on appeal.

However, again we have a question of credibility

there, and again the question was of the credibility of Cantu, the officer, or the defendant, whose credibility was now [8] seriously impaired, in fact, if not fatally impaired by the asking of that question. Now, as time went on, that conviction was reversed, but also this case had already gone to the jury, and the jury found Dr. Bloch guilty, because in the weighing of the scales of the officer as against one who had been previously convicted of a felony, the scales weighed more heavily in favor of the officer than it did of the defendant, and his credibility was very badly damaged.

Now, the prosecutor gambled. He knew that the other case was on appeal, and having known that fact, and having risked his case by asking the question, he should now suffer the consequences.

I have searched far and wide. The Circuit Court passed on the question of whether it was proper to ask the question. They say that if the United States Attorney acted in good faith in asking the question, that then it was under a conflict of authorities of the different circuits proper. But it does not appear that in the Circuit Court of Appeals, nor in the subsequent proceedings, that the question of the effect of a reversal of the first conviction was brought up, or raised, or argued, or presented either to the Circuit Court or on to the Supreme Court of the United States.

I, therefore, within the time still allowed, I filed it last Friday, a petition for rehearing in the Supreme Court of the United States, asking that Court to reconsider [9] the matter of that point, which

was the only point raised in the petition for certiorari originally, but I expanded it on the ground that that issue had not been finally considered or determined by the Circuit Court of Appeals, nor by the Supreme Court of the United States.

I must state to the Court that I did find, subsequent to the writing of that petition, and subsequent to the filing of this motion, I found a case in the California court in which that subject had been raised, but it was raised under a California statute, which permits the impeachment of a witness for any prior conviction of a felony, and the California courts have held that even though the case is on appeal that it was proper to ask the question during the time of the pendency of the appeal. However, in this particular case, the appeal was subsequently reversed, and the issue was also injected there as to the effect of the whole matter, including the reversal, and the Court, the California court held that it was proper for the attorney to ask the question during the pendency of the appeal, but they reversed this case on other grounds. They still reversed the case, but on other grounds, the misconduct of the prosecutor, so that that issue never went back on rehearing. And so I do feel that the Court should know that particular somewhat parallel situation was raised in the California Supreme Court. It was a parallel situation, where the judge had been reversed. [10]

It is in 92 Pacific Second, page 402, at page 405. People versus Braun. I just discovered the case yesterday.

However, your Honor, the case merely in its language passes on the propriety of the prosecutor asking the question during the pendency of the appeal, and has no discussion as to the effect of the reversal of the first conviction, as we have here.

However, your Honor, in the United States courts there is no statute I know of that permits such an impeachment. It falls under common law. And I submit, your Honor, that where the prosecutor gambles, as he did here, on the outcome of the first appeal, knowing that the case was still under appeal, and the first appeal was reversed, that a new trial should be granted in this case, so that the defendant may appear before a jury without the stigma of a non-existent prior conviction of a felony.

As stated in a case I cited to your Honor in my Points and Authorities, Campbell versus United States, that "it seems to us wholly illogical and unfair to permit a defendant to be interrogated about a previous conviction from which an appeal is pending. If the judgment on the conviction is later reversed, the defendant has suffered unjustly and irreparably the prejudice, if any, caused by the disclosure of the former conviction."

And we submit, your Honor, that in this case the [11] defendant has suffered irreparably where the issue was his credibility or Cantu's credibility.

Now, if your Honor please, the affidavit of Mr. Hernandez discloses a course of conduct on the part of the officers in this matter which I feel that your Honor could not in due justice approve. The conduct of the officers, as long as they are conducting

themselves as officers, if they do anything illegal or reprehensible, that is their own affair. But when it comes into court and the Court then puts its final stamp of approval upon it, then it not only becomes the act of the officers, but it becomes the act of the Court as well.

And Mr. Justice Holmes in Olmstead versus the United States, in 277 United States condemns that kind of conduct by any officers, and while he discusses a matter which came up in a wire tapping case—and I understand your Honor has had something about wire tapping here lately which the Supreme Court of the United States has taken over, and you are probably quite familiar with this and the other decisions on the subject—while it deals with other types of offense and not this type of offense, Justice Holmes' condemnation of the conduct of the officers is that the courts cannot properly adopt what the officers have done, because if they do that, then the Court itself has adopted the improper conduct of the officers. And also Mr. Justice Brandeis in a very lengthy opinion, which was later approved in subsequent cases, has [12] condemned this type of action as being against the interest of the Government.

Now, in connection with the affidavit of Hernandez, and in connection with all the evidence in this case, it shows a pattern of entrapment which your Honor has had before you, and which in Sorrells versus The United States is condemned as something that can be interrupted at any stage of the proceedings.

Your Honor has had that issue before you before this time, but I renew it here, because we have a great and important situation of an individual here, a man who is a professional man, and this judgment isn't merely a judgment of imprisonment, which he could do, but it is the wrecking of a career, it wrecks his whole life. It goes to the heart of everything that he has worked for and accomplished. And he did not initiate this matter. He was treating a man whom the Government put in its employ, and then had that man seduce him. There was a seduction in this case as much as a man is often charged with seducing a woman. It was a seduction because the defendant did not go out seeking Cantu. Cantu came seeking him. Then the Government employed Hernandez whom they knew was an addict, and I submit, your Honor, that that kind of conduct ought not to receive the final approval of this or any other American court.

Now, there is one other feature in this case [13] which must be considered by your Honor, and that is the duty of the United States attorney. That duty in producing the evidence is a duty which he had not only to produce the evidence for the Government, but the evidence which might help the defendant in this case. The United States attorney is a minister of justice. He is a quasi-judicial officer. All of the books call him that.

In State versus Osborne, in 103 Pacific at page 62, it is stated:

"It will not do to say that courts are impartial, and that both the courts and district attorneys are

there to protect the accused from wrong as well as to convict the guilty. The law is intended not only for protection against the acts of those who knowingly or intentionally err, but against those as well who do wrong unintentionally, or from an erroneous sense of duty. As stated by the Supreme Court of Michigan in People v. Murray, 89 Mich. 276, 286, 50 N. W. 995, 998, 14 L. R. A. 809, 28 Am. St. Rep. 294: 'It is for the protection of all persons accused of crime—the innocently accused, that they may not become the victim of an unjust prosecution, as well as the guilty, that they may be awarded a fair trial—that one rule must be observed and applied to all.' " [14]

In Berger versus United States, a late case, on the duties of the United States attorney the court there stated:

"The United States Attorney is the representative not of an ordinary party to a controversy, but of a sovereignty whose obligation to govern impartially is as compelling as its obligation to govern at all; and whose interest, therefore, in a criminal prosecution is not that it shall win a case, but that justice shall be done. As such, he is in a peculiar and very definite sense the servant of the law, the twofold aim of which is that guilt shall not escape or innocence suffer. He may prosecute with earnestness and vigor—indeed, he should do so. But, while he may strike hard blows, he is not at liberty to strike foul ones. It is as much his duty to refrain from improper methods calculated to produce a

wrongful conviction as it is to use every legitimate means to bring about a just one.

"It is fair to say that the average jury, in a greater or less degree, has confidence that these obligations, which so plainly rest upon the prosecuting attorney, will be faithfully observed."

Now, the Court goes on to discuss the way it would be observed in that case, but we have in the instant case a [15] matter that was in the possession of the United States Attorney which we feel it was his duty to produce and to disclose to the Court, as well as to counsel, and to give them an opportunity fairly to present the issue on this one issue of credibility. And having failed to do so, we feel that the Court now in its sound discretion should grant a new trial, so that the issues may be fairly tried with all the facts before it, including those which were not produced, but which were within the possession of the Government to produce, and which were in the possession of the Government to enable the Court to know them, and to enable defense counsel to know them.

We submit that on these grounds, as well as on the other grounds which we have set forth in our motion that this court should now grant a new trial. I have cited other cases in my Points and Authorities. I think it is not necessary to go over them. Your Honor is familiar with them.

I urge your Honor to grant a new trial, and also to hold each of the judgments herein pronounced as null and void.

There is one other matter, your Honor, that ap-

peared in my motion, and that is that if the testimony of Hernandez is to be believed, and if the testimony of Dr. Bloch is to be believed, then Cantu's evidence was knowingly perjured. Cantu was an officer of the Government. I do not charge the Government counsel, I charge the Government agent, however, [16] with having produced false testimony in this matter, which we had no opportunity of proving was false at the time of the trial.

As stated in the Mooney versus Holohan case, where a judgment is based upon false testimony, then the due process is violated, and that judgment is a nullity.

And also, in connection with the affidavit of Hernandez, he points out that some of the medicine was given to him and was not entirely in the possession of Cantu, and if that was true, then Cantu's testimony also was false.

In my Points and Authorities, I also cited cases which held that where a conviction is based upon perjured testimony that the Court should grant a new trial.

I submit it, your Honor.

Mr. Murlless: I think counsel's argument overlooks that citation which has been reviewed by the Circuit Court of Appeals, at least once by the Supreme Court of the United States, as the rule of law in this case. It is reported, Bloch vs. United States of America, CA Ninth Circuit, October 12, 1955, in 226 Federal Second at 185.

We resist the motion and have served on counsel a copy of the resistance to motion for new trial.

We think it would be unreasonable to expect that the Government could file affidavits with the freedom and lack of responsibility that is shown in this case. Either six or [17] eight affidavits have been filed, some of them alleging flagrantly false accusations. That it not appear that they are true, I made an affidavit which I would like to lodge with the Court. I don't think its filing is necessary. I swear to its truth.

Mr. Lavine: May we see a copy?

Mr. Murlless: And have signed it, and will serve a copy on counsel.

The Court could not be interested in anything at this time except that which is new, that which is new and that which is relevant. And when I say "new," I mean that which has not been reviewed by this Court twice or three times, by the Circuit Court of Appeals twice, and by the United States Supreme Court at least once.

If there is anything new in any of this last spate of affidavits with which we have been served, it is the use of a new word, that Gilbert Hernandez was secreted during the course of the trial.

I know he wasn't. There is any number of persons that knows that is not true, but for the purpose of this record, if it serves the Court's problem, I made an affidavit that I saw him in the courtroom as I turned from examining one of the witnesses during the course of this trial. That is the only thing here that is new. And the reason I dwell upon the word "new" is because, if your Honor please, the [18] rule of law with respect to whether or not

there was prejudicial conduct of counsel, or prejudicial error in connection with questions asked, the question of whether or not the jury was instructed with respect to entrapment, and this Court's consideration, has been reviewed in these two things, in connection with the evidence with respect of which the Court did instruct on entrapment, have been reviewed at least, after the jury's verdict, twice by this Court, twice by the Circuit Court of Appeals, and at least once by the Supreme Court of the United States; and the rule of law, if that is what he is searching for, is I think reported upon the appeal in this case, and it is to the effect that there is no prejudicial error, there was no prejudicial misconduct of counsel. And I think the Circuit Court of Appeals says that the evidence did not necessitate an instruction on entrapment.

As I recall, this court gave an instruction that was characterized by the Circuit Court of Appeals as abundantly fair. I am not sure I used the exact words.

The Court: No, it was "out of an abundance of caution." I never can tell what they are going to hold up there.

Mr. Murlless: We urge, if your Honor please, that the mandate be spread, that the next procedure be taken in this matter, that is, an execution of the Court's sentence which was made and signed, and upon which there was an appeal so many months ago. [19]

Mr. Lavine: May it please the Court. I am surprised at the paucity of counsel's affidavit. It con-

cedes that all of the other portions of Hernandez' affidavit are true by reason of the fact that there is no denial of it.

And Hernandez has stepped forth and said that he was not permitted to tell defense counsel in the trial about his presence, and the facts of the matter as they existed and were narrated by Cantu in his testimony.

Now, the mere fact that Hernandez was in the courtroom on one day didn't enable defense counsel, who had sought to get the information, to get that information, nor to find out what the true facts are.

The Government has no right to instruct a witness not to disclose the true facts. There is no denial of those matters set out in Mr. Murlless' affidavit.

The case is on all fours with this case in the District of Columbia, which the District of Columbia Circuit Court reversed, in Coates versus United States, where the police officer was not permitted and did not give the information to the defense which they were entitled to have, and which they couldn't inquire and couldn't know about until the trial was over.

And here we have a parallel situation, your Honor. We are not talking about entrapment at this point. We are talking about new evidence which we have produced by affidavit [20] and which stands clear before your Honor as uncontradicted in any respect. In respect to the gravamen of the charges here, the testimony of Cantu that these narcotics were to be used for prostitutes, and Hernandez was supposed to have heard Cantu make the

statements, and Cantu was supposed to have made the statements to Dr. Bloch, and yet we find there was no way of verifying those facts until after the trial. And we are here presenting them to you now on our first opportunity to do so.

I submit, your Honor, that in all fairness a new trial should be granted.

The Court: I don't know whether I have the legal right to grant your motion.

Mr. Lavine: Yes, your Honor, I have authority on that.

The Court: Well, I will tell you what confronts the Court. As a matter of law, or as a matter of the record you have made, if the court would enter an illegal order, the Government, of course, could appeal on that ground. If the Court shouldn't grant the motion for a new trial, that is an appealable order.

Mr. Lavine: On the motion for new trial, your Honor?

The Court: Yes. And it would be an appealable order by the Government, also.

Mr. Lavine: Yes.

The Court: So I think I will place that burden on you. [21]

Mr. Lavine: It is an appealable order on either party.

The Court: Yes. So I will place that burden on you.

Mr. Lavine: The Supreme Court has often said that you are the one who has to pass on it first.

The Court: The Supreme Court isn't in it now. The Supreme Court will enter later.

Mr. Lavine: The Supreme Court says you are the one to pass on it first.

The Court: I will just deny it now and order the mandate spread on the minutes of the Court.

Mr. Lavine: If your Honor pleases, we have an appeal which we desire to present to the Court at this time, and we would ask your Honor to fix bail under Rule 46(2), pending appeal.

The Court: I won't fix bail either.

Mr. Lavine: Can I cite your Honor an authority on that?

The Court: You can cite authorities to substantiate anything.

Mr. Lavine: This is a new case, by Justice Douglas.

The Court: I could tell you something about that, too. I think I even know the case.

Mr. Lavine: The Walcher case?

The Court: No, that isn't the one I have in mind.

Mr. Lavine: You were thinking of this wire tapping case, I think. The Walcher case. It came down December 31st. [22]

The Court: All right. Make your application to the Court of Appeals. I am sure they will grant it.

Mr. Lavine: Will your Honor stay the judgment long enough for me to have a chance to present it to the Court of Appeals? The first time that can be heard is February 27th.

Mr. Murlless: I move the defendant be remanded

to the custody of the United States Marshal for the execution of sentence.

Mr. Lavine: I think we should have our right to have our day in Court on this.

The Court: You may have your day in court.

Mr. Lavine: May we have until the 27th?

The Court: No. The defendant will be committed to the cusody of the Marshal pursuant to the mandate.

Mr. Murlless: May his bond be exonerated, if your Honor please?

The Court: Yes.

(Which was all of the proceedings had in the above-entitled matter at said time and place.) [23]

Certificate

I hereby certify that I am a duly appointed, qualified and acting official court reporter of the United States District Court for the District of Arizona.

I further certify that the foregoing is a true and correct transcript of the proceedings had in the above-entitled cause on the date specified therein, and that said transcript is a true and correct transcription of my stenographic notes.

Dated at Phoenix, Arizona, this 15th day of February, A.D. 1956.

/s/ JANE HORSWELL,
Official Reporter.

[Endorsed]: Filed March 12, 1956. [24]

[Title of District Court and Cause.]

CLERK'S CERTIFICATE TO RECORD ON APPEAL

United States of America,
District of Arizona—ss.

I, William H. Loveless, Clerk of the United States District Court for the District of Arizona, do hereby certify that I am the custodian of the records, papers and files of the said Court, including the records, papers and files in the case of United States of America, Plaintiff, vs. Bernard Bloch, Defendant, numbered C-12340 Phoenix, on the docket of said Court.

I further certify that the attached and foregoing original documents bearing the endorsements of filing thereon are the original documents filed in said case, and that the attached and foregoing copy of minute entry dated February 13, 1956, is a true and correct copy of the original thereof remaining in my office in the City of Phoenix, State and District aforesaid.

I further certify that the said original documents, and said copy of minute entry constitute the record on appeal in said case as designated in the Designations filed therein and made a part of the record attached hereto and the same are as follows, to wit:

1. Indictment.
2. Verdict.
3. Judgment and Commitment.
4. Defendant's Motion for New Trial and Notice of Motion filed February 9, 1956, with affidavits of

Gilbert Ruiz Hernandez and of Wade Church attached.

5. Affidavit of Bernard Bloch, filed February 10, 1956.

6. Affidavit of Robert S. Murlless, filed February 13, 1956.

7. Minute Entry of February 13, 1956, including order denying Defendant's Motion for a New Trial (and to Vacate and Set Aside Judgment).

8. Mandate of U. S. Court of Appeals affirming judgment (Opinion not filed).

9. Order denying bail pending appeal.

10. Defendant's Notice of Appeal.

11. Reporter's Transcript of Proceedings had on February 13, 1956, filed March 12, 1956.

12. Reporter's Transcript of Arguments to the Jury May 27, 1954, filed February 29, 1956, designated by appellee.

13. Appellant's Praecipe (designation) for Record on Appeal, filed February 13, 1956.

14. Appellee's Counter Designation of Record on Appeal, filed February 23, 1956.

I further certify that a reporter's transcript of proceedings of December 20, 1954, and of testimony of Bert C. Dobbs taken February 28, 1955, have not been filed in this case, and that no proceedings were had in said case in this court on February 28, 1955 (Items 6 and 7 of designation).

Witness my hand and the seal of said Court this 13th day of March, 1956.

[Seal] /s/ WM. H. LOVELESS,
Clerk.

[Endorsed]: No. 15066. United States Court of Appeals for the Ninth Circuit. Bernard Bloch, Appellant, vs. United States of America, Appellee. Transcript of Record. Appeal from the United States District Court for the District of Arizona.

Filed March 15, 1956.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 15066

DR. BERNARD BLOCH,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

DESIGNATION OF POINTS ON APPEAL

Pursuant to Rule 17(6), appellant herewith designates his Statement of Points on Appeal in the above-entitled cause:

I.

The District Court has jurisdiction to grant the Motion for a New Trial upon the basis of newly discovered evidence, under Rule 33, Rules of Criminal Procedure for the District Courts of the United States.

II.

The District Court erred in failing to grant the Motion for a New Trial on the basis of newly discovered evidence, under Rule 33, where the newly discovered evidence was unavailable to the accused at the time of trial.

III.

The District Court erred in failing to vacate and set aside the judgment on the basis of evidence wilfully suppressed by the prosecution. Such conduct denied appellant fair trial guaranteed by the Fifth

Amendment to the Constitution of the United States.

IV.

The evidence showed that the witness for the Government, a government officer, knowingly committed perjury. Conviction, therefore, was based upon evidence knowingly perjured in violation of the Fifth Amendment to the Constitution of the United States.

V.

The District Court erred in failing to grant a new trial based upon the fact that evidence relating to a prior conviction of the appellant, which was pending on appeal, was later reversed subsequent to the trial; nevertheless, this alleged prior conviction went to the credibility of the appellant in the trial and affected the fairness of the trial, in violation of the Due Process Clause of the Fifth Amendment to the Constitution of the United States.

Dated: March 30th, 1956.

MORRIS LAVINE,
Attorney for Appellant.

[Endorsed]: Filed March 30, 1956.

No. 15066

In the United States Court of Appeals

For the Ninth Circuit

BERNARD BLOCH,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

Appellant's Opening Brief on Appeal

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Appellant's Opening Brief on Appeal

JURISDICTION

Jurisdiction is based on Title 28, Section 1254, Rules 33 and 39, Rules of Criminal Procedure for the District Courts of the United States.

STATUTES AND RULES INVOLVED

Title 26, U. S. Code, Section 2554(a)—Unlawful and felonious sale of narcotics:

Rule 33, Rules of the District Courts of the United States, reading as follows:

"RULE 33. NEW TRIAL

The court may grant a new trial to a defendant if required in the interest of justice. If trial was by the court without a jury the court may vacate the judgment if entered, take additional testimony and direct the entry of a new judgment. A motion for a new trial based on the ground of newly discovered evidence may be made only before or within two years after final judgment, but if an appeal is pending the court may grant the motion only on remand of the case. A motion for a new trial based on any other grounds shall be made within 5 days after verdict or finding of guilty or within such further time as the court may fix during the 5-day period."

Fifth Amendment to the Constitution of the United States, as follows:

"No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Malitia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life, or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

BRIEF STATEMENT OF THE CASE

The appellant was a duly licensed osteopathic physician in the State of Arizona. Under the laws of that state, he is allowed to treat narcotic addicts. For a period of two years, he had under his treatment a man named Gilbert Hernandez. R. S. Cantu, the narcotic officer of the Federal Government, located at Phoenix, Arizona, placed Hernandez under their employment and got Hernandez to introduce Cantu to the Doctor, and represented that Cantu also needed treatment for his addiction. (R. 27). Approximately two days prior to September 23, 1953, Cantu went to the office of Dr. Bloch and obtained narcotics from the said Dr. Bloch on representation that Cantu was a brother of Hernandez and was addicted and in need of medication. That said representations, in truth and in fact, were false.

In the trial of Dr. Bloch, in which reference is made in this court for the court to take judicial notice of its own record, (being No. 14536, *Dr. Bernard Bloch v. United States of America*), the said Cantu testified that he told Dr. Bloch that he did not want the narcotics for himself but for prostitutes whom he claimed were working for him. (R. 80, pages 104, 105 and pages 120 and 132 of Record 14536). This was strongly denied by Dr. Bloch (R. 40) and such denial is now confirmed by affidavits of Gilbert Hernandez. (R. 30)

Cantu testified that Hernandez was present during this purported conversation. Prior to and at the trial of the action, the defendant sought to have Hernandez

interviewed and Hernandez who was then under the employment as a Special Employee of the Narcotic Division of the Government made an appointment with Dr. Bloch's then attorney in a motel where an effort was made to entrap the attorney into giving some money to Hernandez, while narcotic agents listened in by prearrangement with Hernandez to the conversation in a room that was wired. The attorney, however, did not offer Hernandez any money and Hernandez did not answer any questions relating to the case to the attorney. All this was prearranged by government agents.

During the trial of the action, Hernandez was, according to his own affidavit, told that if he did not cooperate with the Narcotic Agents they would see that his probation in the state courts of Arizona on which he had been placed for a period of five years for forgery would be revoked. The narcotic agents, during the trial, according to his affidavit had him sequestered in the Federal Building and he was told not to tell anything to Wade Church, the attorney for the appellant herein, and was told not to discuss the case with any person and was not called as a witness by the government. The specific affidavit of Hernandez as to this pertinent portion is as follows:

> That shortly before the trial of the above-entitled matter in the above-entitled court, which said trial took place during the 25th, 26th and 27th of May, 1954, the exact date being not remembered by affiant, affiant was contacted by the Federal Narcotics Agents hereinbefore named, to wit, Patrick

Ross, George Dowell and R. S. Cantu, together with Dale Welsh, a member of the City Police Department of the City of Phoenix, Arizona, concerning the fact that one Wade Church, a practicing attorney in Phoenix, Maricopa County, Arizona, the representing the above-named said Bernard Bloch, during the said trial, was attempting to contact affiant and that affiant was told by said Officers to avoid the said Wade Church and not to tell him anything concerning the facts of the case which the Federal Government had against the said Bernard Bloch. That thereafter the said narcotic agents again contacted affiant and told him to call the said Wade Church, then affiant was told to inform the said Wade Church to meet him at a predesignated place at 25th Avenue and Jefferson Street, in the City of Phoenix, Maricopa County, Arizona, and from there to take him to the Plaza Apts Motel at 2511 West Van Buren Street, Phoenix, Maricopa County, Arizona, and to represent to the said Wade Church that affiant was living in said motel, Apartment 4; that affiant was told to take clothes to said Apartment 4 so that the said Wade Church would believe that he was living at said apartment; that affiant was with the said aforementioned narcotic agents and the said Dale Welsh and Bert Dobbs, another Federal Narcotic Agent, when the said Apartment 4, in the above-mentioned motel, was wired for recording; that affiant was told that agents and officers aforementioned would be in Apartment 3 with recording equipment. That affiant did meet the said Wade Church at the corner of 25th Avenue and Jefferson Street, by prearrangement, at which

time the said Wade Church requested affiant to go to his office to discuss the case against the said Bernard Bloch, that because of previous instructions given to affiant by the said Officers, affiant insisted that he would not discuss anything unless at his motel, towit, Apartment 4, Plaza Apts Motel, as aforementioned, that the said Wade Church thereupon agreed to take affiant to said apartment and that affiant and the said Wade Church did go to said apartment. That affiant had been previously instructed by the said aforementioned Federal Narcotic Agents and the said Police Officer Dale Welsh, not to disclose to the said Wade Church any matters concerning the evidence of the Government of the United States against the said Bernard Bloch, but instead to attempt to question the said Wade Church in such a manner so that the said Wade Church would be enticed to offer affiant a bribe for the production of testimony by affiant in behalf of the above-mentioned Bernard Bloch; that the said Ware Church did request that affiant discuss the facts of the case with him, but that as per previous instructions from the said aforementioned officers, affiant refused to disclose to said Wade Church any of the facts concerning the evidence against the said Bernard Bloch, and stated to the said Wade Church that he did not desire to become any more involved in the case than he already was and attempted to have the said Wade Church offer to him a bribe for his testimony, which the said Wade Church never did. That after conversation was had concerning the case against the said Bernard Bloch, and after affiant refused to divulge any informa-

tion to the said Wade Church by reason of his previous instruction, the meeting between the said Wade Church and affiant broke up and the said Wade Church thereafter left affiant at the said motel, Apartment 4; that thereafter the Federal Officers expressed their disgust with affiant for his inability to entrap the said Wade Church.

That during the course of the trial of the said case against the said Bernard Bloch, affiant was secreted in a room in the Federal Building in the City of Phoenix, Maricopa County, Arizona, and instructed not to discuss the case with any person. That affiant was subpoenaed by the Government of the United States to testify at the trial of the above-named Bernard Bloch, but that affiant was not called as a witness in behalf of the Government of the United States, nor was he called as a witness at all in said matter.

That the above-named Bernard Bloch, did not know until subsequent to the trial and subsequent to his conviction what the testimony of affiant would have been had he been called as a witness either by the Government of the United States, or by the defendant Bernard Bloch; that the said Bernard Bloch did not know of said evidence by reason of the fact that affiant refused to divulge any of said matters to the said Wade Church, by reason of instructions given to affiant under threat of revocation of probation.

That on many occasions from and after the introduction of the said R. S. Cantu to the said Bernard Bloch by affiant, the said Federal Officers threatened affiant and told him to leave Phoenix on many occasions giving affiant and his wife

sufficient narcotics to dispel withdrawal symptoms while riding on the bus from Phoenix, stating that the said Bernard Bloch had employed some man with a gun to "get" (Affiant) by reason of his participation in the case against the said Bernard Bloch; that affiant would take the narcotics offered himself and his wife, and would go to the Bus Depot with the said narcotic agents, but would not leave upon the buses indicated for their departure.

/S/ GILBERT RUIZ HERNANDEZ

Subscribed and sworn to before me
this 1st day of February, 1956.
(Seal) /s/ R. N. RENAUD
Notary Public
My Commission Expires: 3-15-58

Wade Church, Attorney-at-law of Phoenix, Arizona also made an affidavit. None of this evidence was discovered or discoverable until after the conviction of the appellant. Thereafter he made his motion for a new trial on February 13th, 1956, in the District Court of Arizona. The said Motion was based upon affidavits which were in no wise contradicted by the government. The only affidavit filed was a 5-line statement by Robert S. Murlless, Assistant United States Attorney, that "Gilbert Hernandez was not secreted nor sequestered during trial as alleged . . . " That he observed Gilbert Hernandez in open court on one of the trial days during trial of this cause. The Government did not deny any of the other charges. The court then ordered the mandate spread and committed the defendant. (R. 42, 43).

In the trial of the action the appellant had been stood convicted of an income tax violation and was asked at that time "if he was convicted of a felony" and he answered "yes". Subsequent to that trial the income tax conviction was reversed and the appellant sinc that time stands unconvicted of any felony. Nevertheless, evidence of that conviction introduced before the jury which tried Dr. Bloch affected his credibility.

After the mandate came down from the U. S. Court of Appeals, following a denial of certiorari by the Supreme Court of the United States, the appellant, on February 13, 1956, moved for a new trial in the United States District Court at Phoenix, Arizona (R. 78). That motion was heard on the grounds herein presented and denied by the District Court at Phoenix on that date. Bail was also denied by the District Court on that date and the appellant was remanded to the custody of the United States Marshal at Phoenix. He was later transported to the Federal Prison at Terminal Island, California. This appeal is from the order of Judge Ling, denying a new trial upon this motion.

SPECIFICATION OF ERRORS AND GROUNDS FOR APPEAL

The appellant specifies the following errors upon which he grounds his Motion for a New Trial.

I.

THE SUPPRESSION OF THE TESTIMONY OF WITNESS GILBERT HERNANDEZ CONSTITUTED GROUNDS FOR A NEW TRIAL AND DENIED THE APPELLANT DUE PROCESS OF LAW GUARANTEED BY THE FIFTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES.

II.

THE CONVICTION OF THE APPELLANT WAS BASED UPON FALSE AND PERJURED TESTIMONY AND THEREFORE VIOLATED THE DUE PROCESS CLAUSE OF THE FIFTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES.

III.

THE REVERSAL OF THE FELONY CONVICTION OF DR. BLOCH ON THE INCOME TAX EVASION, WHICH EVIDENCE AFFECTED THE CREDIBILITY OF THE WITNESS, ENTITLED THE APPELLANT TO A NEW TRIAL.

IV.

THE APPELLANT WAS UNLAWFULLY ENTRAPPED IN VIOLATION OF THE FIFTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES.

ARGUMENT

I.

THE SUPPRESSION OF THE TESTIMONY OF WITNESS GILBERT HERNANDEZ CONSTITUTED GROUNDS FOR A NEW TRIAL AND DENIED THE APPELLANT DUE PROCESS OF LAW GUARANTEED BY THE FIFTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES.

The testimony of Officer Cantu, which is contained at pages 104, 105, and 120 and 132 of the original record, is to the effect that Officer Cantu testified that when he talked to Dr. Bloch he (Cantu) stated he did not want narcotics for himself but for some girls who were prostitutes, whom he claimed were working for him. He also stated that Gilbert Hernandez was present when he had the conversation about this matter of not wanting the narcotics for himself but for the prostitutes. At that time Hernandez was under subpoena by the government. He was also in the employment of the government and being paid by the government, and the government could have produced him to corroborate the testimony if it could have been corro-

borated. The defense sought to interview Hernandez to determine the true facts of the matter and tried to get in touch with Mr. Hernandez for the purposes of ascertaining the truth. Wade Church, a reputable attorney of Phoenix, Arizona, made an appointment with Mr. Hernandez for the purpose of getting him to tell the facts. Instead, however, the narcotic officers arranged a trap in which they had Hernandez meet Mr. Church in a room that was wired up to an adjoining room, and they asked Hernandez to try to solicit a bribe from Mr. Church, which Mr. Church refused. Mr. Hernandez, however, declined to discuss any facts.

Mr. Hernandez stated, in his subsequent affidavit, that he was ordered by the government to refuse to divulge any information to Church. This constituted a wilfull suppress of vital evidence which should have been available to the defendant in the trial.

In *Gordon v. United States,* 344 U.S. 414, this court said, in referring to the failure of the government to produce documents in the possession of the government:

> "Indeed, we would find it hard to withstand the force of Judge Cooley's observation in a similar situation that 'The State has no interest in interposing any obstacle to the disclosure of the facts, unless it is interested in convicting accused parties on the testimony of untrustworthy persons.' "

While the court there was speaking of documents, yet the line of reasoning is just as important in the production of a government employed witness.

The court, there, further said, in referring to limiting the cross-examination based upon documents not produced:

> "But this principle cannot be expanded to justify a curtailment which keeps from the jury relevant and important facts bearing on the trustworthiness of crucial testimony."

In the case of *Coates v. United States,* 174 Fed. 2d 959, the United States Court of Appeals for the District of Columbia had before it an appeal in a robbery case. A police officer had gone to the place where the robbery had occurred and found no evidence about any $20.00 bill there which was supposed to have been taken in the robbery in a crap game. The defendant did not learn of the possession of this corroborative evidence until after the trial was over and on motion for a new trial, under Rule 33, the District Court of Appeals for the District of Columbia remanded the case for a new trial under Rule 33.

In the instant case the appellant was unable to furnish and secure the evidence that Gilbert Hernandez was able to and did furnish in his affidavit until long after the trial, and he now urges it under Rule 33, Rules of the District Courts of the United States.

It was the duty of the government to have produced Hernandez and not to have suppressed the facts or knowledge that he had and not to have instructed him (as it did) not to give any information to the defense. Such conduct constituted extrinsic fraud upon the court and upon the defense, under the rule of

Throckmorton v. United States, 98 U.S. 61. Numerous cases hold that where a party is prevented from presenting his case fully to the court that it constitutes extrinsic fraud which entitles a person in equity, even after the time for appeal or other direction has expired, to set aside the judgment. The leading Federal case on that, *United States v. Throckmorton,* 98 U.S. 65, 25 L. Ed. 93.

> "When the unsuccessful party has been prevented from exhibiting fully his case, by fraud or deception practiced on him by his opponent, a new trial should be granted."

Fraud is extrinsic such as the prevention of the presence of material witnesses which entitled a person to a new trial. *(Thompson v. Thompson,* 38 Cal. App. 2d 377, 106 P. 2d 60; *Hewett v. Linstead,* 49 Cal. App. 2d 607, 122 P. 2d 353, 355, 357.)

In *Hewett v. Linstead, supra,* an heir who knew of the existence of other heirs and for the purpose of defrauding such heirs and benefitting himself failed to notify the court of the existence of such heirs. He was guilty of extrinsic fraud. (And see: *Smith v. Smith,* 125 Cal. App. 2d 154, 270 P. 2d 613; *Sears v. Rusden,* 39 Wash. 2d 412, 235 P. 2d 819.)

Preventing the presence of a material witness is extrinsic fraud.

> *Godfrey v. Godfrey,* 30 Cal. App. 2d 370, 83 P. 2d 357.

It was the duty of the district attorney to produce Hernandez or allow him to be interviewed by the defense for this vital evidence.

In *State vs. Osborne,* 103 Pacific 62, it is stated:

> "It will not do to say that courts are impartial, and that both the courts and district attorney are there to protect the accused from wrong as well as to convict the guilty. The law is intended not only for protection against the acts of those who knowingly or intentionally err, but against those as well who do wrong unintentionally, or from an erroneous sense of duty. As stated by the Supreme Court of Michigan in *People v. Murray,* 89 Mich. 276, 286, 50 N.W. 995, 998, 14 L.R.A. 809, 28 Am. St. Rep. 294: 'It is for the protection of all persons accused of crime — the innocently accused, that they may not become the victim of an unjust prosecution, as well as the guilty, that they may be awarded a fair trial—that one rule must be observed and applied to all.' "

In *Berger v. United States,* a late case, on the duties of the United States attorney, the court there stated:

> "The United States Attorney is the representative not of any ordinary party to a controversy, but of a sovereignty whose obligation to govern impartially is as compelling as its obligation to govern at all; and whose interest, therefore, in a criminal prosecution is not that it shall win a case, but that justice shall be done. As such, he is in a peculiar and definite sense the servant of the law, the twofold aim of which is that guilt shall not escape or innocence suffer. He may prosecute

with earnestness and vigor—indeed, he should do so. But, while he may strike hard blows, he is not at liberty to strike foul ones. It is as much his duty to refrain from improper methods calculated to produce a wrongful conviction as it is to use every legitimate means to bring about a just one.

"It is fair to say that the average jury, in a greater or less degree, has confided that these obligations, which so plainly rest upon the prosecuting attorney, will be faithfully observed."

It will be noted that the affidavit of Hernandez was uncontroverted in any material respect on the Motion for a New Trial. The prosecutor only filed a five line affidavit in which he asserted that Hernandez had not been sequestered and that he saw him one day in the courtroom. In no other respect did he contradict the affidavit of Hernandez, which now stands as undisputed testimony.

Where there is evidence in the possession of the government which would aid the defendant, the government is duty bound to produce that evidence, since the government prosecutor represents all of the people and not merely one side.

Berger v. United States, 79 L. Ed. 1314, 295 U.S. 78.

The prosecutor had a duty to produce Gilbert Hernandez, who Cantu claimed was present during conversations between Cantu and the defendant regarding the purported getting of narcotics for "girls" who

were prostitutes, which testimony Gilbert Hernandez denies in affidavits and testimony before this court.

Where the government is in possession and control of evidence which, if presented, might have materially influenced the jury to reach a different conclusion and fails to produce it and it is not available to the defense until after the trial, a new trial should be granted as such evidence is newly after the trial and is material (*United States v. Smith,* Fed. case No. 16341; *Gichanov v. United States,* 281 Fed. 125), and failure to produce it at the trial was not owing to want of diligence (*Green & Moore Co. v. United States,* 19 Fed. 2d 130; *Silva v. United States,* 38 Fed. 2d 465) and where the prosecutor did not produce it but rather prevented the defendant from being able to produce it at the trial, such procedure amounts to extrinsic fraud, for which a new trial is always proper. *(U. S. v. Throckmorton,* 98 U. S. 61, 25 L. Ed. 93.)

DeLouis v. Meek, 2 Green (Iowa) 55, 50 Am. Dec. 491;
Smith v. Lowry, 1 John (N.Y.) 320.

In *Bryant v. Stilwell,* 24 Pa. 314, the court said:

> "To smother evidence is not much better than to fabricate it. A party who shuts the door upon a fair examination, and thus prevents a jury from learning material facts, must take the consequence of any honest indignation which his conduct may excite . . . . . It ought to be understood that where one party has the subject matter of the controversy under his exclusive control, it is never

safe to refuse the witnesses on the other side an opportunity to examine it unless he is able to give a very satisfactory reason."

Even the Bible condemns conduct where it is declared "cursed be he that removeth his neighbor's landmark." (Deut. C. 27, 17.)

II.

THE CONVICTION OF THE APPELLANT WAS BASED UPON FALSE AND PERJURED TESTIMONY AND THEREFORE VIOLATED THE DUE PROCESS CLAUSE OF THE FIFTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES.

The use of evidence knowingly perjured violates the due process clause of the Fifth Amendment to the Constitution of the United States and makes judgments a nullity.

> *Mooney v. Holohan,* 292 U.S. 103, 79 L. Ed. 791; *Hysler v. Florida,* 315 U.S. 411, 86 L. Ed. 934.

> "If a state, whether by the active conduct or the connivance of the prosecution obtains a conviction through the use of perjured testimony, it violates civilized standards for the trial of the guilty or innocent and thereby deprives an accused of liberty without due process of law. *Mooney v. Holohan,* 294 U.S. 103, 79 L. Ed. 791."

A new trial may be granted where it appears that material testimony given at the trial was perjured.

United States v. Johnson, 149 Fed. 2d 31;
Martin v. United States, 17 Fed. 2d 973, Cert. denied, 275 U.S. 527, 72 L. Ed. 408.

Where a party seeking a new trial was taken by surprise when the false testimony was given and was unable to meet it, or did not know of its falsity until after the trial, he should be granted a new trial.

United States v. Johnson, 149 Fed. 2d 31.

III.

THE REVERSAL OF THE FELONY CONVICTION OF DR. BLOCH ON THE INCOME TAX EVASION, WHICH EVIDENCE AFFECTED THE CREDIBILITY OF THE WITNESS, ENTITLED THE APPELLANT TO A NEW TRIAL.

Since the prosecutor gambled on whether the felony conviction would stand and since the trial of the accused the felony conviction on the tax evasion issue has been reversed, it would be fair and just to grant a new trial under Rule 33 of the Rules of the District Courts of the United States, since this is newly discovered evidence which was not available at the time of trial, and if the prosecutor took his chances in asking the impeaching question, knowing that the first conviction might be reversed, he should now be required to take the results of that reversal.

In the instant case there was only one witness against Dr. Bloch and the question of his credibility as against the credibility of the defendant was in dispute. The weight then given to a conviction of felony, which has since been reversed, cannot be told and it is therefore important that the judgment be reversed so that he may have the weight of his testimony measured as against that of Cantu without the onus of the conviction of a felony.

IV.

THE APPELLANT WAS UNLAWFULLY ENTRAPPED IN VIOLATION OF THE FIFTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES.

The evidence clearly shows that the defendant was entrapped.

In *Sorrells v. United States,* 287 U. S. 435, the court stated that this issue may be raised at any stage of the proceeding. The evidence now shows clearly from the affidavit of Gilbert Hernandez that the defendant was entrapped and this is newly discovered evidence which was not available heretofore to the defense. Such newly discovered evidence is vital to clear the reputation of the appellant. Gilbert Hernandez was a government agent who became such during his treatment by the appellant. The full knowledge and scope of the entrapment as disclosed by Hernandez's affidavit was only obtained by the defense after

the trial had been concluded. We urged it in our Motion for a New Trial and we urge it again to show that the defendant was unlawfully entrapped and that he is entitled to a reversal of the judgment.

For all of which reasons we pray for a new trial in this case.

Respectfully submitted,

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No. 15066

IN THE

United States
Court of Appeals
For the Ninth Circuit

BERNARD BLOCH,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

BRIEF OF APPELLEE

Resisting Appeal from the United States District Court for the Judicial District of Arizona

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BRIEF OF APPELLEE

Resisting Appeal from the United States District Court for the Judicial District of Arizona

DESCRIPTIVE STATEMENT OF CASE

1. Jurisdictional Statement

The United States District Court for the Judicial District of Arizona had jurisdiction hereof under *Title 18, United States Code, Section 3231,* and the United States Circuit Court of Appeals for the Ninth Circuit has jurisdiction hereof under *Title 28, United States Code, Section 1291.*

2. Opinion

There was no written opinion of the trial court. This is the second appeal of this defendant (particularly on alleged Specifications of Error Nos. 3 and 4). The instant appeal is from an order denying Motion for New Trial alleging newly discovered evidence.

**Transcript of Record (15066) pp. 18, 19 and 20*

This is the second Motion for a New Trial on Newly Discovered Evidence made to the trial court. The first was made prior to December 20, 1954.

T. R. pp. 9, 10, 11, 12 and 13

The testimony, taken on above mentioned Amended Motion for New Trial on Newly Discovered Evidence, contained substantially all assertions made in the present motion. This prior Amended Motion was made, pending appeal. It was denied December 20, 1954, without opinion.

T.R. p. 16

The opinion of the United States Circuit Court of Appeals for the Ninth Circuit, in *appeal No. 14536,* which is the law of this case with respect to two of the Specifications of Error and grounds for appeal (c.f. Appellant's Brief, pp. 10 and 11) is contained in *226 F. 2d 185 et seq.*

c.f. *Bloch vs. United States, Oct. 12, 1955, id.*

3. Statutes Violated

The appellant was charged in an indictment containing eight counts. This indictment charged illegal acquisition of and sale of narcotic drugs. *26 U.S.C.A.*

**Unless the context indicates otherwise, the Transcript of Record, Court of Appeals No. 15066 will be indicated by the use of T.R. followed by a number indicating the page referred to. When further clarity requires, the Circuit Court of Appeal numbers, that is, either 15066 or 14536 (the prior appeal) will be specified.*

2554(a) (sale); 2554(g) (acquisition); I.R.C. 1939.

T.R. (14536) pp. 3, 4, 5 and 6

The two counts of the indictment alleging violation of *Section 2554(g), Title 26* U.S.C.A., were dismissed in advance of trial.

T.R. (14536) p. 17

The defendant was a medical man, an osteopath, and the counts of the indictment upon which he stands convicted alleged the sales of narcotic drugs "not pursuant to the Treasury Department Order Form . . . not pursuant to a prescription . . . and not in the course of the professional practice . . . (of this doctor) . . . ".

For the convenience of this court the following statutes are cited or set forth, in pertinent part, verbatim:

"Section 2554. Order forms—(a) *General Requirement.* It shall be unlawful for any person to sell, barter, exchange, or give away any of the drugs mentioned in section 2550(a) except in pursuance of a written order of the person to whom such article is sold, bartered, exchanged, or given, on a form to be issued in blank for that purpose by the Secretary . . .

"(c) *Other exceptions* . . .

"(1) *Use of drugs in professional practice.* To the dispensing or distribution of any of the drugs mentioned in section 2550(a) to a patient by a physician, dentist, or veterinary surgeon registered under section 3221 in the course of his professional practice only: *Provided,* . . .

"(2) *Prescriptions.* To the sale, dispensing, or distribution of any of the drugs mentioned in section 2550(a) by a dealer to a consumer under and in pursuance of a written prescription issued by a

physician, dentist, or veterinary surgeon registered under section 3221: *Provided, however, . . .*"

Title 26 U.S.C.A., 2554

It will be noted that there are references, in the statute above cited, to *Sections 3221 and 2556, Title 26 U.S.C.A.* It will be further noted that *Section 3221, supra*, refers to *Section 3220,* infra. The last two mentioned Sections relate to *Chapter 27, Internal Revenue Code, Special Occupational Taxes, Narcotics. Section 3221, supra,* which requires registration of persons engaging in the Special Occupations designated in *Section 3220: Title 26 U.S.C.A. Section 3220* imposes a special tax upon wholesalers, dealers and physicians who deal in narcotic drugs.

This appeal is prosecuted under *Title 18 U.S.C.A., F. R. of Crim. P. 33,* and under the provisions of *The Constitution of the United States of America, V Amendment.*

4. Issues on Appeal

We believe this appeal is notable principally for its violence of language. Principal issue is the validity of the assertions of perjury and suppression of evidence *(T.R. pp. 18, 19 and 20; Specifications of Error I and II, Appellant's Brief p. 10).* On these assertions is founded argument that there was: (1) Misconduct of counsel; (2) Abuse of trial court's discretion, in refusing new trial on alleged newly discovered evidence (suppressed and falsified at trial); and (3) Therefore a deprivation of liberty without due process of law *(V Amendment of The Constitution of the United States).*

5. Pages of Transcript of Record upon which Appellee Relies in Resistance of This Appeal.

Appellee relies upon the pages of *Transcripts of Record (both 15066 and 14536)* cited in the following paragraphs, together with those cited in *Statement of Facts—Corpus Delicti, paragraph 5, Brief of Appellee (14536), pages 6, et seq..*

INTRODUCTION TO ARGUMENT

It is not believed necessary nor proper, in the face of the allegations of reprehensible malfeasance (accorded to government counsel and government agent), to urge that the alleged perjury and suppression does not involve material facts. However, perfection in investigation and prosecution is not expected of counsel for the government, nor of government narcotics agent. It is necessary therefore to examine the testimony at the trial *(T.R. (14536))*, to establish whether or not there was any significant suppression or falsification. We ask that this Court take judicial notice of the files and records in *Bloch vs. United States of America, Ninth Circuit, Court of Appeals No. 14536.*

ARGUMENT

1. Alleged Suppression of Testimony (Specification of Error No. 1).

Specification of Error No. I *(Appellant's Brief, page 10)* accuses government counsel of " . . . suppression of testimony . . . ". " Suppresion of Testimony" is sometimes (and was in this case we believe) the duty of a conscientious government counsel. A stigma is cast where it is shown that there has been a suppression of *evidence;* there is no stigma attached to the suppression of testimony of the usual narcotic addict. His testimony is not necessarily evidence.

The testimony that Gilbert Hernandez was an addict is not controverted.

T.R. (14356) p. 275 (Policeman Welch), 183; (15066) p. 26.

The testimony that an addict respects nothing but his addiction and his misery is not contradicted.

> " . . . The symptoms are very acute and rather extreme, driving the individual to almost any limit in order that he may receive relief. It might be said that drug addiction is really a continued process of seeking relief from withdrawal of the drug. The symptoms deprive a man almost of his reason, and they are responsible in many instances for many crimes, in an attempt on the part of the addict to secure his drug. You might say that the life of an addict is devoted to one thing, and that is assuring a constant supply of his drug . . . "

T. R. (14536) p. 254 (Dr. Meyers)

The testimony of such a person could not reasonably be expected to contribute to truth. Neither would such testimony be reliably credible nor cumulative, to support the credibility of other witnesses. This is further demonstrated by the fact that Hernandez was in court, on the days of the trial, and defendant could not rely upon his testimony, and refused to call him or subscribe to his testimony.

T.R. p. 42

Defendant and his counsel were willing to talk to this addict, (two years under defendant's ministrations) if not surreptitiously, still at the convenience of the witness and not at the convenience of the government (whose agent he had been).

T. R. (15066) pp. 35, et seq. (W. Church, Attorney at Law) and pp. 30, et seq. (Hernandez)

The testimony of this man could not be relied on, as a contribution to truth, nor as a contribution to evidence.

Suppression of testimony is not suppression of evidence; no blame nor stigma should attach, as in this case, where incredible, incompetent and/or unreliable testimony was not brought before the court.

2. Alleged Suppression of Evidence.

Assuming, arguendo, that the testimony of Hernandez would have been competent, it is still submitted that there was no suppression of evidence. The principal objection, or assertion of perjury or suppression, is directed to Mr. Cantu's statements that he stated to appellant, at the time of the purchases of narcotic drugs, that the narcotics were for his "girls" (prostitutes). But, appellant testified to substantially the same thing (that Mr. Cantu described himself as a whoremaster):

" . . .

Q. Did you ever give him any injections at all in your office?

A. No, I never have . . .

A. . . . It was at that time he told me—I asked him what he did for a living; and he told me, he showed me his hands and says, 'I never did a day's work in my life.'

I said, 'How do you support yourself?'

He says that he had a young married woman who was married to an elderly man supporting him. He told me that her husband was not capable of satisfying her sexually, so he took over, for which she took care of him. And he wanted

. . .

A. He also said that he had three girls working for him at the Arizona Manor, and that he took care of these girls, too. He was a great lover. I asked him what he had that was so wonderful. He said he just was a good man.

Q. Now, did he ever represent to you that these girls were engaged in an occupation of ill fame?

A. He told me these three girls that he had working for him were at the Arizona Manor, but at no time did he ask me for narcotics for them.

Q. He never asked you for narcotics for the girls?

A. No. That was on his own. He just offered this information by himself. I asked him how he made a living, and he said that—he actually spread his hands out to indicate that he had no callouses on them, never worked a day in his life . . . "

T.R. (14536) pp. 198 and 199

" . . .

Q. Did he ever tell you, Doctor Bloch, that he wanted this for three prostitutes, that were addicts?

A. No, sir, he never said that at any time. He never mentioned anything about prostitutes until the following visit, the one after that.

Q. You mean the visit on November 10, 1953?

A. That is right . . . "

T.R. (14536) p. 194

The verity of the above testimony of appellant is most seriously questioned upon consideration of the following compilation of the various sales of narcotic drugs (note; reference to November 10, 1953, above, and purchases on October 29 and 30, 1953, in following schedule): (All *Transcript of Record* references are to *C. A. Ninth Circuit 14536):*

"3"—September 23, (T.R. p. 96), morphine solution (T.R. p. 46), approximately one cubic centimeter (T.R. p. 46), no quantitive analysis (T.R. p. 73);

"4A"—September 24, (T.R. pp. 100, 101), morphine solution (T.R. pp. 51, 54), approximately 10 c.c. volume (T.R. p. 74), containing one-eighth grain of morphine per cubic centimeter (T.R. p. 74), for $40.00 (T.R. p. 101);

"5A"—October 29, 1953 (T.R. p. 103), morphine solution (T.R. pp. 54, 104), 20 c.c. (T.R. p. 68), one-eighth grain of morphine per cubic centimeter (T.R. p. 74), for $30.00 (T.R. p. 105);

"6A"—October 30, (T.R. p. 105, et seq.), morphine solution (T.R. p. 58), 15 c.c. (T.R. p. 67), one-quarter grain morphine per cubic centimeter (T.R. p. 75), in connection with government's exhibit "6B" below, purchased for $40.00;

"6B"—purchased at the same time as exhibit "6A", derivitive of opium (T.R. p. 58), two tablets (T.R. p. 106), purchased for $20.00 (T.R. pp. 106, 107);

"7A"—November 10 (T.R. p. 111), morphine solution (T.R. p. 60), 30 c.c. (T.R. p. 67), one-sixteenth grain of morphine per cubic centimeter (T.R. p. 75), for $80.00 (but with a credit for 10 cubic centimeters more) (T.R. p. 111);

"8A"—November 16 (T.R. p. 112), morphine solution (T.R. p. 64), 8 c.c. (T.R. p. 67), one-eighth grain of morphine per cubic centimeter (T.R. p. 75), the execution of the

credit for 10 c.c. of morphine solution mentioned in reference to "7A", above, which was purchased for $80.00 (T.R. p. 112);

"9A"—November 19 (T.R. p. 113), morphine solution (T.R. p. 65, 66), 20 milliliters, or 20 c.c. (T.R. p. 67), one-eighth grain of morphine per cubic centimeter (T.R. p. 76), sold to agent Cantu for $50.00, of recorded money (T.R. 115).

In a period of less than 60 days, approximately 104 c.c. of morphine-atropine was purchased, in quantities ranging from one to thirty c.c. In the 48 hours of October 29 and 30, 35 c.c. of morphine-atropine was purchased together with two one-twentieth grain tablets of dilaudid. The purchases pursuant to the foregoing schedule are not to be presumed to be for the consumption of a single person.

The purchases of these quantities of two deadly poisons, at the times and in the amounts above set forth, is presumed to be for the consumption of some persons other than an ambulatory (alleged) narcotics addict. Furthermore, the testimony was that a confirmed drug addict concerns himself only with the misery of today; he does not store up drugs for use at another time:

"...

Q. Now, you state the withdrawal. What do you mean by withdrawal?

A. Well, morphine or any of the narcotics produce in the individual a condition which demands a continued use of the drug. In fact, if the drug is not constantly supplied the individual will then suffer certain symptoms.

The symptoms are very acute and rather extreme, driving the individual to almost any limit in order that he may receive relief. It might be said that drug addiction is really a

continued process of seeking relief from withdrawal of the drug. These symptoms deprive a man almost of his reason, and they are responsible in many instances for many crimes, in an attempt on the part of the addict to secure his drug. You might say that the life of an addict is devoted to one thing, and that is assuring a constant supply of his drug . . . "

T. R.(14536) pp. 253 and 254

To summarize, briefly; the perjury and suppression assertions, contained in Appellant's Brief and in his Motion for New Trial, are not supported by the multitude of circumstances to be found in the Transcript of Record of the trial. These assertions degenerate into a question of quantum of testimony (1) as to whether the drugs were supposed to be for Mr. Cantu's "girls" or for someone else to whom he was supplying drugs; and (2) whether reference to the "girls" was made on Mr. Cantu's first trip, his second or his third trip: At best, a sorry basis on which to claim perjury.

The manner in which Mr. Cantu testified concerning the references to the "girls", clearly demonstrates that he was telling the truth, and that the appellant's recollection was faulty, or false. This is by reason that, on Mr. Cantu's first testimony concerning the "girls", he testified in the manner of a man who has omitted the obvious; he went back and cleared up something that he had forgotten to state, because in generality it was obvious, or because in specificity it wasn't important in the first place:

" . . .

A. I saw him again October 29th.

Q. And under what circumstances?

A. Well, it was following orders, and I telephoned him before I went out to his office, and he said it was all right for me to come out.

I walked into the office, and this Miss Woods, I presume her name is Miss Woods, met me in the reception room.

I asked for the defendant Bloch, and she said that he was in his private office, for me to walk in.

I walked in, and he greeted me, and I told him I would like to have some more of that medicine that we had got previously from him.

And he told me that was a morphine something, I don't know whether he said morphine sulphate, or morphine something.

So we had talked about what I was using it for, and he asked me if the girls had liked it. I was supposed to be giving this narcotic to some girls I had working in a resort hotel, and I said they didn't like it very much, that they would rather have dilaudid.

In the meantime, I got my money out, and I gave him $30, and he motioned me towards the same back room, and I went with him, and by means of a hypodermic needle he extracted some solution from a bigger bottle, and I noticed the big bottle was marked 'Morphine.' "

T.R. (14536) pp. 102 and 103

It is notable that this is the first time in the trial that Mr. Cantu testified concerning the "girls". He did so almost as an after thought, after an omission of the obvious. It is notable that this is the only time, on direct examination in the case in chief, that Mr. Cantu testified about the "girls". Apparently the importance of this testimony was not appreciated by either government counsel or government agent. Nowhere is there any testimony supporting the present affidavit of Hernandez, that the narcotic drugs were being sold to Cantu for the use, also, of Hernandez.

T.R. (15066) p. 30

Omission of the testimony of Hernandez, from the government's case in chief, was not the suppression of evidence; if it was the suppression of anything, it was the suppression of incompetent and confusing testimony, even if it is assumed that the narcotic addict, Hernandez, would have testified at the trial in accordance with his affidavit made almost two years later. It is apparent from the consideration of these further circumstances, and of the testimony *(T.R. 14536),* that there is not any perjury in this case. *(c.f. Paragraphs infra).*

Alleged Perjury.

The foregoing paragraphs are cited to the proposition that Hernandez's testimony would have been incompetent. They also establish, we believe, that no one could nor can tell what his testimony would have been, had he been sworn as a witness. We urge that the rambling nature of Hernandez's affidavit *(T.R. (15066) pp. 26-34)* demonstrates the incompetence, the irresponsibility and the unreliability of his testimony.

As examples of the demonstration of incompetence, irresponsibility and unreliability, may we call the court's attention to the following assertions *(Affidavit of Hernandez, T.R. (15066) pp. 26-34):* He states that he is an addict: That he was given *an injection by hypodermic needle* by appellant on September 23, 1953 (in accordance with previous practice): That the drugs purchased were purchased on the promise that they were for Mr. Cantu and for Hernandez: And, that " . . . During the course of the trial . . . the affiant was secluded in a room in the Federal Building in the City of Phoenix . . . "

We submit that the assertions run the gamut, from the truthful to the fantastic.

Nowhere is it controverted that he was an addict, at the time of the trial. On the other hand, the rooms in the Federal Building in the City of Phoenix are public offices, under the custody of United States District Judge of the District of Arizona: Hernandez admits, furthermore, that he was sworn as a witness in a trial before that judge: He could not have been secluded in the Federal Court House Building. It is notable that he does not state the circumstances of this seclusion, nor the persons responsible therefor, assuming that he was not in the sole custody of the Court (in his witness status).

There was no perjury in the case. During negotiatiations for seven purchases, for a sum of money in excess of $200, it is presumed that the persons would talk about something. One of the principal subjects suggested for conversation would be the quality of the product sold, and the satisfaction of the consumers. Mr. Cantu's testimony of the conversations is consonant with the circumstances surrounding the purchases. He told the truth to the best of his ability. Appellant-defendant makes no endeavor to describe the general tenor of these conversations, though he remembers portions of them with much more particularity than did Mr. Cantu (c.f. *T.R. (14536) pp. 198 and 199 quoted supra).*

The assertion of perjury is irresponsible, and is founded on false affidavits.

From the foregoing paragraphs, Nos. 1 and 2, it is apparent that there was neither suppression of evidence nor perjury. Gilbert Hernandez's testimony was incompetent and unreliable. Mr. Cantu testified as a

man who had omitted the obvious, when he first testified concerning the "girls". Government counsel could not be guilty of suppression of evidence, when there was such grave doubt that it would be evidence, much greater doubt that it would be credible. We believe that no one could tell, at the time of the trial, what the narcotic addict would testify to. Appellant knew the truth; he treated Hernandez for two years; he was in a better position, to know what the testimony would be, than was anyone else.

Defendant-appellant testified that there were references to "girls". He was present at the conferences or conversations. There was no omission of the conflict in evidence. It appears that the refusal of the government to call Hernandez was the subject matter of much of the argument of counsel to the jury.

T.R. pp. 66, 72 and 73

The remedy available to defendant-appellant, knowing (so he says) what the truth of the matter was, and to what Gilbert Hernandez would testify (if competent and reliable), was to call Gilbert Hernandez, who was in attendance upon the court; then claim surprise, if the testimony was not as it was expected to be, and seek the court's approval for the cross-examination of an adverse witness, on grounds of the alleged critical nature of the surprise testimony, and government's failure to call the witness.

As Judge Denman said in *Brandon vs. United States, infra*:

> "One cannot withhold such evidence at the trial, and, being convicted, seek a second chance before another jury by then producing it . . . "

Brandon vs. United States, 1951, 190 F. 2d 175, 178

cf. Wagner vs. United States, 9th Circuit, 118 F. 2d 801, 802

cf. Johnson vs. United States, infra.

Cases cited by appellant do not support the propositions, as applied to this case, that there was perjury, that there was suppression of evidence (amounting to misconduct), nor that there was an abuse of trial court's discretion. Principally appellant's Brief contains cases where default judgment was obtained allegedly by extrinsic fraud. In none of appellant's cases was the testimony (which was not adduced) that of a witness who was incompetent or unreliable.

It is not extrinsic fraud for government counsel to refuse to call to the witness stand a witness of questioned competence, questioned credibility, or questioned reliability. For example:

> " 'Obviously, he (Chin Poy) is a person whom a jury would disbelieve.' Doubtless that is why the government did not call him at the trial; and doubtless, for the same reason, the government would not call him if there were a new trial."
>
> *United States vs. On Lee, 2d Circuit, 1953, 201 F. 2d 722 at 725*

It is notable that the above indicated case *(On Lee)* went to the Supreme Court of the United States twice: (1) *345 U. S. 936,* cert. denied. *(201 F. 2d 722),* and (2) *343 U. S. 747* (opinion on writ of certiorari to *193 F. 2d 306).* In none of the opinions (including dissents) is it held that the circumstances (generally like those complained of in the instant case) constitute extrinsic fraud.

3. Alleged Newly Discovered Evidence.

Proposition of Law No. 1 The granting of Motion for New Trial, on alleged newly discovered evidence, rests in the sound discretion of the trial court.

In a narcotics prosecution, speaking for the United States Court of Appeals for the Ninth Circuit, Judge Dietrich had this to say:

> " . . . One of the grounds upon which defendant moved for a new trial was newly discovered evidence, supported by numerous affidavits which in the main assail the character and credibility of one of the government witnesses and tend to show that she was untruthful in some of the testimony she gave. Generally the granting or refusing of a new trial is within the discretion of the court; and new trials upon this ground are not favored. Under the circumstances, defendant must have known or had good reason to anticipate that his witness would testify for the government, but there is no showing at all of diligence. The alleged false testimony was brought out on cross-examination as to matters purely incidental and collateral. Upon the whole, while the showing against the credibility of the witness is persuasive, we cannot say that there was an abuse of discretion in denying the motion upon this ground . . . "
>
> *Casey vs. United States,* 9th Circuit, 1927, 20 F. 2d 752 at page 754.
>
> *cf. Brandon vs. United States, 9th Circuit, 1951, 190 F. 2d, page 175*

As distinguished from *Casey vs. United States* (*supra*), in the present case we believe that, upon the whole, the showing against the credibility of the witness is *not* persuasive. Even though it was stated to be persuasive, in that case, still it was held that there was no showing of abuse of discretion.

The above Proposition of Law does not seem to be controverted, as a general rule. Neither is its corollary, as stated by Judge Dietrich, to the effect that Motions for New Trial on the ground of newly discovered evi-

dence are not looked upon with favor by courts of appeal. This latter ruling is particularly applicable to the circumstances of the instant case. Here appellant seeks to impose upon the government liability for failure to call an irresponsible witness.

cf. Johnson vs. United States, 8th Cir., 32 F. 2d 127

United States vs. On Lee, supra.

There was no abuse of discretion in the Denial of Motion for New Trial under the circumstances of the case at bar.

Proposition of Law No. 2 To require the granting of Motion for New Trial, for newly discovered evidence, there must ordinarily be present and concur five verities, to-wit: (a) The evidence must be, in fact, newly discovered, i.e., discovered since the trial; (b) Facts must be alleged from which the court may infer diligence on the part of the movant; (c) The evidence relied on, must not be merely cumulative or impeachment; (d) It must be material to the issues involved; and (e) It must be such, and of such nature, as that, on a new trial, the newly discovered evidence would probably produce an acquittal.

The above Proposition of Law is taken verbatim from the case *Brandon vs. United States, 9th Circuit, 1951, 190 F. 2d 175 at page 178.* It is notable that it is a quotation by Judge Denman, from the case *Johnson vs. United States, supra,* which has been quoted with approval by this court many times.

In the present case, admitting the materiality of the issue involved, it is demonstrated in the circumstances of the case, and in the testimony at the trial thereof, that the evidence is merely cumulative or impeaching,

and that it is not newly discovered, i.e., discovered since the trial: For example; no one denies but that Bernard Bloch was a party to the conversations concerning the "girls". The defendant-appellant sought the statement of the addict, Gilbert Hernandez, in advance of trial. Gilbert Hernandez was in the courtroom during the trial. Defendant-appellant could have called Gilbert Hernandez, and if surprised by his testimony, could have impeached him upon cross-examination, after a request to the court.

It affirmatively appears that each of the assertions of the affidavits is either incompetent, irrelevent (or both) or that it is not *newly discovered*, with the possible exception of the allegation that Hernandez was confined during trial in a room in the Federal Court House Building. This is the only allegation of something that can qualify as *newly discovered*. This assertion was put in issue by affidavit.

T.R. (15066) page 42

It was not abuse of discretion to refuse a Motion for New Trial, founded upon alleged newly discovered evidence, of questionable competence, put in issue by affidavit.

c.f. United States vs. *Marachowski,*
7th Cir. 1954, 213 F 2d 235

Casey vs. *United States, supra*

May we quote from one more of the many cases, where in circumstances like the case at bar, it is held that it is not abuse of discretion, to deny motion for new trial, under *Rule 33.*

" . . . After the appeal had been taken in this case the appellant made application to this court to remand the case to the District Court for the purpose

of enabling it to entertain a motion for a new trial on the ground of newly discovered evidence. Pursuant to this petition we remanded the case and an application for a new trial on the ground of after-discovered evidence was made and heard by the court below. The after-discovered evidence relied upon, however, was not as to the facts at issue in the case, but was merely evidence affecting the credibility of the defendant Haynes who testified for the Government. It consisted of testimony as to statements alleged to have been made by Haynes while confined in prison that he had received certain inducements to testify in favor of the Government. The witness who supplied this evidence was himself an inmate of the same prison with a record of five convictions of felonies. He was obviously himself of very doubtful credibility. The court below after considering the after-discovered evidence refused a new trial and upon a re-argument adhered to this action. We are satisfied that it did not abuse its discretion in so doing.

Judgment affirmed."

Goodman v. United States, Third Circuit, 1938, 97 F. 2d 197, at p. 199

It was not an abuse of discretion to refuse to grant Motion For New Trial on Newly Discovered Evidence, where the newly discovered evidence was by affidavit of a material witness, of questionable competence, whom government counsel failed to call to the witness stand, and whose testimony, if it were evidence, would have been only cumulative and/or impeaching.

Prior Conviction Reversed-Entrapment.

Early in November of 1953, the defendant was on trial for alleged Federal income tax evasion. On November 9, 1953, the jury returned a verdict of guilty of one count, not guilty of the other count, in that income tax evasion case. Judgment and commitment on

said verdict was appealed to this court, and reversed on April 11, 1955.

Bloch vs. United States, April 11, 1955, Ninth Circuit 221 F. 2d 786; Rehearing Denied 223 F. 2d 297 (June 14, 1955)

In *Ninth Circuit Court of Appeals No. 14536 (226 F. 2d 185),* the first appeal in the instant (Narcotics) prosecution, argument was had on the 23rd day of September, 1955. Though the defendant-appellant represented to the Supreme Court of the United States, in Petition for Rehearing From the Denial of the Petition for Writ of Certiorari and Motion to Recall Mandate, filed in the instant case, that this court's attention had not been specifically drawn to the fact of the reversal of the conviction in the tax case, we believe that the reversal of the conviction in the tax case is not *newly discovered evidence*, to require a relitigation, on appeal, of the determination of this court.

It seems to the writer, that all significant aspects of the specifications of error numbers III and IV, concerning the reversal of the conviction in the tax case, and the asserted defense "entrapment", are closed by the decision and opinion in *Bloch vs. United States, 226 F. 2d, 185.* The following quotations, from that opinion, seem to be the rule of law applicable to the two alleged specifications of error, Nos. 3 and 4, contained in Appellant's Brief, pages 10 and 11 thereof.

> " . . . As we read the applicable decisions we do not hesitate to say that . . . the Assistant United States Attorney . . . could very reasonably conclude that the question was proper and be well within the bounds of propriety in asking it.
>
> Counsel representing appellant at the trial must have thought the question proper because he made no objection to it, nor did he move to strike . . .

Appellant says he was entrapped. We see no merit in this contention . . .

Judgment affirmed . . . "

Id., 226 F. 2d, p 188, et seq.

CONCLUSION

There was no perjury in this case: And suppression of testimony is not suppression of evidence. Even the Government may choose between witnesses, on the bases (amongst other bases; individually or together) of the relative credibility or competence of the witnesses.

The granting or denial of Motion for a New Trial is within the discretion of the trial court. It is highly improbable, if not impossible, that the questioned testimony of the addict would change the result *(c.f. Verdict, T.R. (14536) p. 22)* in this case.

Where affidavit, in support of Motion for New Trial on the grounds of Newly Discovered Evidence, is controverted in its only assertion which could be considered newly discovered, and where that allegation is, in the nature of things, highly improbable if not impossible, then denial of Motion for New Trial is not an abuse of discretion.

Judgment should be affirmed.

Respectfully submitted, August 4, 1956.

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United States Attorney
for the District of Arizona

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Phoenix, Arizona

Attorneys for Appellee

Mailed copy hereof this ..... day
of August, 1956, to Counsel of Record
for Appellant.

No. 15068

United States Court of Appeals

for the Ninth Circuit

BERNARD MITCHELL,

Appellant,

vs.

UNION PACIFIC RAILROAD CO., a Corporation; CHICAGO NORTHWESTERN RAILROAD CO., a Corporation,

Appellees.

Transcript of Record

Appeal from the United States District Court for the Southern District of California Central Division.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.—8-15-56

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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In the District Court of the United States, Southern District of California, Central Division

No. 15634-T

BERNARD MITCHELL,

Plaintiff,

vs.

UNION PACIFIC RAILROAD CO., a Corporation; CHICAGO NORTHWESTERN RAILROAD CO., a Corporation; DOE 1, a Corporation; DOE 2, a Corporation, and DOES 3 and 4, Individuals,

Defendants.

COMPLAINT FOR DAMAGES

Comes Now the Plaintiff, Bernard Mitchell, and for Cause of Action Against the Defendants and Each of Them Alleges as follows:

I.

That plaintiff does not at the present time know the true names and capacities of the defendants named herein as Doe 1, Doe 2, Doe 3 and Doe 4, and sues said defendants under such fictitious names for the reason that he cannot ascertain at the present time their true names and capacities; that your plaintiff asks leave of the Court to amend this Complaint by inserting the true names of the defendants Doe 1, Doe 2, Doe 3 and Doe 4 when the same have been ascertained. [2*]

*Page numbering appearing at foot of page of original Certified Transcript of Record.

II.

That the Union Pacific Railroad Company is a corporation duly authorized and engaged in interstate commerce and duly authorized to do business in the States of California, Iowa and Illinois, and plaintiff is informed and believes and upon such information and belief alleges that said corporation is duly authorized to do business in each and every state in the United States.

III.

That the Chicago Northwestern Railroad Company is a corporation duly engaged in interstate commerce and duly authorized to do business in the states of California, Iowa and Illinois, and plaintiff is informed and believes and upon such information and belief alleges that said corporation is duly authorized to do business in each and every state in the United States.

IV.

That Bernard Mitchell is a citizen of Ireland and a resident of the State of California, and that at the times and places set forth in this Complaint, said plaintiff was in the process of traveling to the State of California from his residence and home in Ireland to California.

V.

That at all times set forth in this Complaint, the plaintiff was the sole owner of a certain fox terrier dog named Pudsy.

VI.

That the fox terrier dog named Pudsy owned by the plaintiff herein had been specially raised and trained by the plaintiff through years of patience, effort and the expenditure of great sums of money and large amounts of time by the plaintiff herein to be an educated trick dog used for [3] educational and entertainment purposes.

VII.

That the purpose of the plaintiff coming to the State of California was to place said dog in the entertainment field by exhibiting said dog at personal appearances in the State of California and throughout the United States and by placing of said dog on television and in the movies.

VIII.

That the plaintiff had exhibited said dog in the country of Ireland for money, and that through the use of said dog, plaintiff had received large amounts of money and publicity to the effect that said dog was the "Wonder Dog of Europe."

IX.

That on or about the 24th day of June, 1952, at approximately 6:00 p.m. of said date, said plaintiff delivered said dog named Pudsy to the defendants herein and each of them in the City of Chicago, State of Illinois, and that said defendants and each of them agreed to convey said dog on the same train upon which the plaintiff was riding to the City of Los Angeles, California.

X.

That at all times mentioned herein, the defendants were advised that said dog was a valuable exhibition dog trained for educational and entertainment purposes, and that said plaintiff was advised by the agents of the defendants that an agent of the defendants would be in charge of the railroad baggage car in which the dog Pudsy was to travel and present therein during the trip to Los Angeles, and that said agent would care for the feeding, watering, providing of air and other essentials necessary to keep and preserve safely the dog owned by the plaintiff.

XI.

That plaintiff was also advised by agents of the [4] defendants that immediately after boarding the train, he would be allowed access to the car in which it was necessary for the plaintiff's dog to travel, and that said plaintiff would have an opportunity to feed, water and care for the said dog herein; that relying upon said statements and acts the plaintiff allowed said animal to be placed in the custody of the defendants.

XII.

That shortly after plaintiff boarded said train, he requested access to the railroad car in which his dog was being carried and was advised that no one was in charge of said car; that said car was sealed and that no one could enter said car; that plaintiff advised numerous of the defendants agents that his dog Pudsy should not be locked up alone without

food and water, and that said plaintiff begged and entreated said agents of the defendants numerous times to allow him access to said baggage car to feed, water and check the ventilation for said dog as it had been promised he would be able to do; that the agents of the defendants and each of them steadfastly and wrongfully denied plaintiff access to his dog and did not provide a party in said car to take care of the plaintiff's dog as had been promised.

XIII.

That the agents of the defendants well knew that there was no one in said baggage car to feed, water and check the ventilation, and well knew that the plaintiff would not be able to visit with and care for his said dog.

XIV.

That plaintiff relied upon the statements and actions of defendants' agents to the effect that he would be able to care for his dog and that someone would be present to care for his dog, and upon such reliance, plaintiff delivered [5] his dog to the care and custody of the defendant; that if said statements and actions had not been made as set forth above, the plaintiff would not have allowed his dog to be transported by the defendants.

XV.

That while en route said dog, due to lack of care, food, water and ventilation and lack of someone in said baggage car to care for the said dog, and by reason of the failure of said defendants to have an

attendant care for said dog or to allow plaintiff to care for said dog, said dog named Pudsy died.

XVI.

That as a direct and proximate result of the fraud, concealment and subsequent loss of plaintiff's dog, plaintiff has been damaged in the sum of approximately $100,000.00.

XVII.

That the acts and actions of the defendants and each of them as set forth above were made wilfully and wantonly with a flagrant indifference to the consequences of the defendants' acts, and that by reason of said wilfullness, wantoness and flagrant in difference, plaintiff demands as exemplary punitive damages the sum of approximately $100,000.00.

Comes Now the Plaintiff and for a Second Cause of Action Alleges as follows:

I.

Plaintiff hereby makes reference to Paragraphs I to XIII, inclusive, of the First Cause of Action and hereby incorporates the same as though fully set forth.

II.

That the defendants and each of them while having control and possession of said dog named Pudsy, negligently failed to give proper attention to said animal by giving it the necessary food, water, light and ventilation and furnishing an attendant. [6]

III.

That as a direct and proximate result of defendants' negligence as aforesaid, the dog of the plaintiff named Pudsy died while en route and while in the possession of the defendants.

IV.

That as a direct and proximate result of the death of said dog named Pudsy, plaintiff has been damaged in the sum of $100,000.00.

Comes Now the Plaintiff and for a Third Cause of Action Alleges as follows:

I.

Plaintiff hereby makes reference to Paragraphs I to XIII, inclusive, of the First Cause of Action and by such reference hereby incorporates the same herein as though fully set forth.

II.

That while plaintiff's dog was in the possession of the defendant, the defendants' wilfully and wantonly and with a flagrant indifference to the consequences failed to furnish suitable care, supervision for said dog while in transit and to furnish proper food, water, light and ventilation; that said defendants wilfully, wantonly and flagrantly failed to have an attendant in charge of the baggage car and that said defendants' wilfully, wantonly and flagrantly refused to allow plaintiff to care for his dog as promised, and that by reason of said wilful, wanton

and flagrant indifference to the consequences, said dog of the plaintiff died.

III.

That as a direct and proximate result of the death of said plaintiff's dog, plaintiff was damaged in the sum of $100,000.00, and that by reason of the wilful, wanton and [7] flagrant indifference to the consequences of the defendants, plaintiff demands the sum of $100,000.00 as exemplary and punitive damages herein.

Wherefore, plaintiff prays judgment as follows:

1. The sum of $100,000.00 on the first, second and third causes of action.

2. The sum of $100,000.00 as exemplary and punitive damages on the second and third causes of action.

3. For costs of suit and for such other and further relief as to the Court may seem proper in the premises.

MONROE, CHULA & LINES,

By /s/ GEORGE H. CHULA.

Duly verified.

[Endorsed]: Filed June 18, 1953. [8]

[Title of District Court and Cause.]

ANSWER OF CHICAGO AND NORTH WESTERN RAILWAY COMPANY

Defendant, Chicago and North Western Railway Company, sued and served in the above-entitled ac-

tion as "Chicago Northwestern Railroad Co., a Corporation," for answer to plaintiff's complaint admits, denies and alleges as follows:

Answer to First Cause of Action

I.

Said defendant has no knowledge, information or belief sufficient to enable it to answer the allegations of Paragraphs IV, V, VI, VII and VIII of the First Cause of Action and basing its answer on that ground said defendant denies said allegations and each of them. [10]

II.

Said defendant admits the allegations of Paragraph IX of the First Cause of Action so far as the same pertain to this defendant.

III.

Said defendant denies the allegations of Paragraphs X, XI, XII, XIII, XIV, XV, XVI and XVII of the First Cause of Action, and each of them, and specially denies that plaintiff suffered damage in the sum of One Hundred Thousand Dollars ($100,000.00), or any other sum or amount whatsoever.

IV.

For a Separate and Second Answer and Defense to the First Cause of Action, said defendant alleges that prior to any of the times mentioned in the complaint and during all such times said defendant had duly filed with the Interstate Commerce Com-

mission and had published and kept open to public inspection, all in the manner prescribed by the Federal Interstate Commerce Act and by the rules and regulations of the Interstate Commerce Commission, its Western Baggage Tariff No. 25-13, effective June 15, 1948, Rule 7-G, of which was and is as follows:

"The limit of value on an uncrated dog will be twenty-five dollars ($25.00). Single shipments exceeding that value must not be accepted for transportation in baggage service. This does not preclude a passenger making two or more shipments, each shipment separately valued at not exceeding twenty-five dollars ($25.00). The limit of value on one or more dogs, shipped in one crate, will be twenty-five dollars ($25.00), unless the shipper declares an increased valuation at time of checking and pays one dollar ($1.00) for each one hundred dollars ($100.00) or fraction thereof over the carrier's liability of twenty-five dollars ($25.00). Where passengers make shipment of two or more crates, a separate valuation will [11] be required on each crate. Declaration of value exceeding three hundred dollars ($300.00) per crate will not be permitted."

That the plaintiff did not declare a greater value than twenty-five dollars ($25.00) for the said dog, nor did the plaintiff make any payment or offer of payment of the rate and charge set forth in said tariff for any such declaration of greater value. That on the contrary, the plaintiff, in order to se-

cure the minimum rate for the transportation of said dog, signed a declaration that the said dog was valued at not exceeding twenty-five dollars ($25.00) and in the case of loss or damage to the dog, plaintiff would not make claim for a greater amount than that sum. A photostatic copy of said declaration of value, executed by the plaintiff as aforesaid, is marked Exhibit A, attached hereto and by this reference made a part hereof.

That under the provisions of the Federal Interstate Commerce Act it is unlawful for the defendant to deviate from the provisions of said tariff and in particular from the provisions of Rule 7-G thereof hereinabove quoted and, therefore, if plaintiff should be entitled to a recovery in any sum whatsoever on account of the death of said dog, such recovery is limited to the sum of twenty-five dollars ($25.00).

Answer to Second Cause of Action

I.

For answer to the allegations of Paragraphs IV, V, VI, VII and VIII of the First Cause of Action, as the same are incorporated by reference into the Second Cause of Action, said defendant refers to and incorporates herein the allegations of Paragraph I of its Answer to First Cause of Action.

II.

Said defendant admits the allegations of Paragraph IX of the First Cause of Action, as the same are incorporated by reference [12] into the Second

Cause of Action, limiting said admission, however, to such allegations of said paragraph as are applicable to this defendant.

III.

Said defendant denies the allegations of Paragraphs X, XI, XII and XIII of the First Cause of Action, as the same are incorporated by reference into the Second Cause of Action.

IV.

Said defendant denies the allegations of Paragraphs II, III and IV of the Second Cause of Action, and each of them.

V.

For a Second and Separate Answer and Defense to the Second Cause of Action, said defendant refers to and here incorporates the allegations of Paragraph IV of its Answer to First Cause of Action.

Answer to Third Cause of Action

I.

For answer to the allegations of Paragraphs IV, V, VI, VII and VIII of the First Cause of Action, as the same are incorporated by reference into the Third Cause of Action, said defendant refers to and incorporates herein the allegations of Paragraph I of its Answer to First Cause of Action.

II.

Said defendant admits the allegations of Paragraph IX of the First Cause of Action, as the same are incorporated by reference into the Third Cause

of Action, limiting said admission, however, to such allegations of said paragraph as are applicable to this defendant.

III.

Said defendant denies the allegations of Paragraphs X, XI, XII, and XIII of the First Cause of Action, as the same are incorporated by reference into the Third Cause of Action.

IV.

Said defendant denies the allegations of Paragraphs II and [13] III of the Third Cause of Action, and each of them.

V.

For a Second and Separate Answer and Defense to the Third Cause of Action, said defendant refers to and here incorporates the allegations of Paragraph IV of its Answer to First Cause of Action.

Wherefore, said defendant prays judgment for its costs and for all proper relief.

E. E. BENNETT,

EDWARD C. RENWICK,

MALCOLM DAVIS,

JACK W. CRUMLEY,

DONALD M. LADD, JR.,

By /s/ MALCOLM DAVIS,

Attorneys for Defendant, Chicago and North Western Railway Company. [14]

EXHIBIT A

[Baggage Tag]

Form 106

Chicago and North Western Railway Co.

Station .....

(Date): 6-14, 19.....

Valuation of Baggage

The property covered by checks numbered

5114

Is Valued at Not Exceeding

$25 .....

and in case of loss or damage to such property, claim will not be made for a greater amount.

Number of Passengers *Bernard Mitchell*

Amount Paid *10071 Garden Grove Blvd.*

(Signed) *Garden Grove,*

Address *California.*

Number and Street

.....

City State

Baggage of excess value will be charged for subject to tariff regulations.

[Matter set in italics appeared in longhand on the photostat of the original tag.]

Duly verified.

Affidavit of service by mail attached.

[Endorsed]: Filed November 2, 1953. [15]

[Title of District Court and Cause.]

MOTION FOR SUMMARY JUDGMENT

The defendants Chicago and North Western Railway Company and Union Pacific Railroad Company hereby move the Court to enter summary judgment for the plaintiff in the sum of Twenty-five Dollars ($25.00), in accordance with the provisions of Rule 56 of the Rules of Civil Procedure, on the grounds that the pleadings and affidavits hereto attached and marked Exhibits A, B and C show that the plaintiff is entitled to judgment as a matter of law in the sum of Twenty-five Dollars ($25.00) only.

Dated: December 22, 1953.

E. E. BENNETT,
EDWARD C. RENWICK,
MALCOLM DAVIS,
JACK W. CRUMLEY,
DONALD M. LADD, JR.,
By /s/ MALCOLM DAVIS,
Attorneys for Said
Defendants. [18]

[Title of District Court and Cause.]

AFFIDAVIT OF E. B. PADRICK IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT

State of Illinois,
County of Cook—ss.

E. B. Padrick, being first duly sworn deposes and says:

I am agent for various railroad companies acting under powers of attorney on file with the Interstate Commerce Commission and State Commissions and have personal knowledge of the facts herein set forth.

This affidavit is submitted in support of the motion of the defendants, Union Pacific Railroad Company, a corporation, and Chicago and North Western Railway Company, a corporation, for summary judgment herein for the purpose of showing that there is in this action no genuine issue as to any material fact and that the plaintiff is entitled to judgment as a matter of law herein in the [19] sum of Twenty-five Dollars ($25.00) only.

As agent as aforesaid acting for various railroad companies, including Union Pacific Railroad Company and Chicago and North Western Railway Company, I hereby state that there was filed with the Interstate Commerce Commission and with the various State Commissions through which Union Pacific Railroad and Chicago and North Western

Railway operate, Western Baggage Tariff No. 25-13 issued May 12, 1948, effective June 15, 1948, which tariff set forth the rules, regulations, rates and charges applying in connection with the transportation of baggage and other articles of property over various railroads, including Union Pacific Railroad and Chicago and North Western Railway, from the effective date of June 15, 1948, to and including August 31, 1953. The said tariff was duly printed and kept open to public inspection as well as being filed as aforesaid, all in full compliance with the provisions of the Interstate Commerce Act and particularly Title 49, Section 6, Paragraph (1) of the United States Code. There were also furnished ample copies of said tariff to Chicago and North Western Railway Company for posting as required by said section. A copy of said tariff will be served upon counsel for plaintiff in the above-entitled action contemporaneously with the service upon counsel of a copy of this affidavit.

/s/ E. B. PADRICK.

Subscribed and sworn to before me this 3rd day of December, 1953.

[Seal] /s/ A. F. HUCKSOLD,
Notary Public in and for
Said County and State.

EXHIBIT B

[Title of District Court and Cause.]

AFFIDAVIT OF C. E. QUACKENBUSH IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT

State of Illinois,
County of Cook—ss.

C. E. Quackenbush, being first duly sworn deposes and says:

I am General Passenger Agent of Chicago and North Western Railway Company and have personal knowledge of the facts herein set forth.

This affidavit is submitted in support of the motion of the defendants Union Pacific Railroad Company, a corporation, and Chicago and North Western Railway Company, a corporation, for summary judgment herein for the purpose of showing that there is in this action no genuine issue as to any material fact and that the plaintiff is entitled to judgment as a matter of law herein in the [21] sum of Twenty-five Dollars ($25.00) only.

As General Passenger Agent of Chicago and North Western Railway Company prior to and on June 24, 1952, I caused to be complied with, on behalf of that company, all applicable requirements of the Interstate Commerce Act and regulations and orders of the Interstate Commerce Commission with respect to making available to the public, for inspection, all tariffs applicable to transportation

of passengers and baggage, including Western Baggage Tariff No. 25-13. In particular, copies of said Western Baggage Tariff No. 25-13, that tariff being the one applicable to the transportation of a dog, as baggage, in connection with the transportation of such a dog and its owner from Chicago to Los Angeles on the "City of Los Angeles," were kept available for inspection by the public in the depot of Chicago and North Western Railway Company at Chicago, Illinois, on June 24, 1952.

/s/ C. E. QUACKENBUSH.

Subscribed and sworn to before me this 15th day of December, 1953.

[Seal] /s/ P. J. SESTERHENN,
Notary Public in and for Said County and State.

My Commission Expires May 5, 1954. [22]

EXHIBIT C

[Title of District Court and Cause.]

AFFIDAVIT OF E. R. FOSTER IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT

State of Illinois,
County of Cook—ss.

E. R. Foster, being first duly sworn deposes and says:

I am employed by Chicago and North Western Railway Company as a Baggage Check Clerk in the Chicago Passenger Terminal of that company and was so employed on June 24, 1952, and have personal knowledge of the facts herein set forth.

This affidavit is submitted in support of the motion of the defendants Union Pacific Railroad Company, a corporation, and Chicago and North Western Railway Company, a corporation, for summary judgment herein for the purpose of showing that there is in this action no genuine issue as to any material fact and that the plaintiff is entitled to judgment as a matter of law herein in the [23] sum of Twenty-five Dollars ($25.00) only.

As Baggage Check Clerk at the Chicago Passenger Terminal aforesaid on June 24, 1952, and at the hour of about 5:40 p.m. of that day, the plaintiff above-named, Bernard Mitchell, came to me and stated that he desired to check his dog through from Chicago to Los Angeles on the train known as "City of Los Angeles No. 103" commencing that evening. Said Bernard Mitchell exhibited a passenger ticket entitling him to passage on said train. In accordance with the provisions of Western Baggage Tariff No. 25-13, I asked Mr. Mitchell to make out the valuation slip required and saw him do so in his own handwriting. A photostatic copy of the said valuation slip is attached hereto, marked Exhibit A, and made a part hereof. I actually saw Mr. Bernard Mitchell write in the figure "25" in the line under the printed statement, "Is valued at not ex-

ceeding," and also saw him write out his name and address in the blank spaces farther down on the valuation slip. I then punched his ticket to indicate that baggage had been checked on the ticket and returned the ticket to him. The dog was placed in a crate in the presence of Mr. Mitchell, the crate and dog together were weighed and then placed with other baggage to be taken out and put aboard the train.

/s/ E. R. FOSTER.

Subscribed and sworn to before me this 19th day of November, 1953.

[Seal] /s/ MARY C. MARIGA,
Notary Public in and for Said County and State.

[The valuation slip, Exhibit A, mentioned in the foregoing affidavit is identical to valuation slip attached to the answer, see page 16.] [24]

Western Baggage Tariff
No. 25-13
(Cancels No. 25-12)

* * *

Rule 6—Public Entertainment Paraphernalia
(See Note B on following page)

Transporting Public Entertainment Paraphernalia in Regular or Special Baggage Cars for Organizations or Individuals Giving Theatrical

Performances, Concerts, Lectures or Other Public Entertainments, Indoors or Out of Doors.

* * *

(C) *Domestic* and *trained animals* weighing not to exceed three hundred (300) pounds each, used in producing a theatrical performance or other public entertainment, indoors or out of doors, may be checked and transported in regular baggage service or in special baggage cars at the convenience of the carrier, under the following conditions:

(1) They must be accompanied by owners or caretakers who present valid transportation and who will provide proper facilities for loading and unloading, feeding and watering, whenever necessary.

(2) They must be properly presented for shipment, which will be made at convenience of the carrier.

(3) *If crated,* charge will be based on the actual weight, with allowance shown in paragraph (D) of this rule.

(4) *If not crated,* they must either be weighed or a careful estimate made of the weight and charge based on gross weight without free allowance. Minimum charge for each uncrated animal will be three dollars ($3.00), *except* that dogs on leashes will be handled in regular baggage service in accordance with conditions and charges prescribed in Rule 7.

(5) *Animals which may be dangerous,* inconvenient or undesirable to transport in baggage cars in regular service such as elephants, lions, leopards, tigers, etc., and those weighing more than three hundred (300) pounds, will be handled only in special cars, subject to special baggage car rules.

(6) The *foregoing covers only animals* which are used exclusively and regularly in *giving theatrical performances or other public entertainments,* indoors or out of doors, but does not include race horses, polo ponies or horses owned by individuals for private use or exhibition, or horses of Sheriff's Posses, shippers of which should be referred to the Freight Department or Express Company.

(D)

1. One hundred and fifty (150) pounds of property described in this rule, not exceeding one hundred dollars ($100.00) in value, will be transported in regular baggage service without charge for each adult passenger and seventy-five (75) pounds, not exceeding fifty dollars ($50.00) in value, for each child traveling on a half ticket, except that this allowance shall not be in addition to the free baggage allowance on personal baggage described in Rules 4 and 10. The liability of the carriers shall not exceed twenty-five dollars ($25.00) in value on each piece of property described in this rule, and the total liability shall in no case exceed one hundred dollars ($100.00) for each adult passenger and fifty dollars ($50.00) for each child trav-

eling on a half fare ticket unless at time of checking the passenger declares a greater value and pays for same in accordance with Rule 11, paragraphs (F) and (G). [53]

* * *

Rule 7—Dogs

(See Note C on next page)

1. (A) When accompanied by a passenger presenting valid transportation, Dogs not exceeding twenty-five dollars ($25.00) in value (see paragraph (G), and which are not intended for other persons, nor for sale, may be transported in baggage service, subject to the conditions shown in Paragraphs (B) to (J), inclusive:

(B) Each uncrated Dog must be securely muzzled and provided with a strong close-fitting collar or harness, to which must be securely fastened a chain or other strong leash.

(C) Uncrated dogs will not be checked beyond junction points where ferry or vehicle transfer is required. (See Note C on next page, applying to dogs checked via Denver and Rio Grande Western Railroad Company, Laramie, North Park & Western Railroad Company, Saratoga & Encampment Valley Railroad Company, Southern Pacific Company (Pacific Lines) or Union Pacific Railroad Company.)

(D) When shipped in a strong substantial crate, or other substantial container fitted with handles, one or more dogs may be included in one shipment.

(E) A revenue check will be attached to each uncrated Dog or to each crate containing one or more dogs.

Charges:

Uncrated Dogs: Charge for gross weight of dog at rate shown in Rule 21, Table A. When gross weight is less than 50 pounds, charge should be made on basis of 50 pounds.

Crated Dogs: Charge for gross weight of dog or dogs with crate, at rate shown in Rule 21, Table A. If gross weight is less than 25 pounds, charge should be based on basis of 25 pounds.

(F) When dogs are checked from station where an agent is on duty all charges must be prepaid.

(G) The limit of value on an uncrated Dog *will* be twenty-five dollars ($25.00). Single shipments exceeding that value *must not* be accepted for transportation in baggage service. This does not preclude a passenger making two or more shipments, each shipment separately valued at not exceeding twenty-five dollars ($25.00).

The limit of value on one or more Dogs, shipped in one crate, will be twenty-five dollars ($25.00),

unless the shipper declares an increased valuation at time of checking and pays one dollar ($1.00) for each one hundred dollars ($100.00) or fraction thereof over the carrier's liability of twenty-five dollars ($25.00). Where passengers make shipment of two or more crates, a separate valuation will be required on each crate. Declaration of value exceeding three hundred dollars ($300.00) per crate will not be permitted.

(H) Dogs do not form any part of the baggage allowance, and when more than one Dog or more than one crate containing one or more Dogs, is presented by a passenger, each Dog or each crate shall be regarded as a separate shipment and separate charges collected on each, as per paragraph (E) of this rule. See paragraph (*I*), for exceptions. [54]

(I) Dogs used in producing a theatrical performance or other public entertainment, indoors or out of doors, will be considered as public entertainment paraphernalia, provided they are carried in strong crates or other substantial containers fitted with handles, and will be handled under the provisions of Rule 6, paragraph (C).

Note—Dogs intended for exhibition, bench shows, field trials, races, coursing matches, or any uncrated dog, will not be regarded as public entertainment paraphernalia, but will be handled in accordance with the provisions of this rule, except that dogs intended for exhibitions or bench shows

may be handled in special baggage cars in accordance with special baggage car rules.

(J) Dogs must be claimed immediately upon arrival at destination. Carriers do not assume obligation to store or care for Dogs at stations or wharves. Passengers must attend to feeding and watering Dogs en route and at stations or wharves. [55]

* * *

Baggage or Property of Excess Weight or Value

Rule 11—Excess Baggage

* * *

(F) *Excess Value*—Unless a greater sum is declared by a passenger *(see Exceptions below)* and charges paid for excess value at time of delivery to carrier, the value of baggage or property belonging to, or checked for a passenger, shall be deemed and agreed to be not in excess of the amount specified in Rules 5, 6 and 10, and the carriers issuing and participating in this Tariff will not assume liability for a greater sum in case of loss or damage. See paragraph (G) for lines requiring declaration of value in writing before checking.

If passenger declares according to the form prescribed by checking carrier (see paragraph (G)), a greater value than specified in the rules mentioned in the preceding paragraph, there will be an *additional charge* at the rate of fifteen (15) cents for each one hundred dollars ($100.00) or fraction

thereof, above such agreed maximum value. *Minimum* charge fifteen (15) cents.

Declaration of value exceeding maximum of twenty-five hundred dollars ($2,500.00) will not be permitted on baggage or property owned by one passenger presented as one shipment.

A separate declaration of value must be required for each shipment on which the liability is limited to twenty-five dollars ($25.00). (See Rules 5(B), 5(C), 6(D) and 7.) Separate declaration of valuation must also be taken when baggage is checked to two destinations on same ticket, as provided in Rule 1(D), total value declared on both lots not to exceed maximum of twenty-five hundred dollars ($2,500.00) per passenger. For limit of maximum value, see Rule 9.

A separate declaration of value must be required for each shipment of Kit Bags (including Sea Bags, Barracks Bags, and Aviators' Kit Bags), Shoulder Packs, Trunk Lockers and Officers' Bed Rolls, where the liability is limited to one hundred dollars ($100.00) per passenger for any one or more of these articles, unless a greater value is declared at time of delivery to carrier and charge in this rule is paid for such increased valuation. A separate declaration of valuation must also be taken when baggage is checked to two stations on the same ticket, as provided in Rule 1(D), total value declared on both lots, not to exceed maximum of twenty-five hundred dollars ($2,500.00) per passenger. For limit of maximum value, see Rule 9.

If shipper declines to state the value of the baggage or other property on the form prescribed, it will not be accepted in baggage service.

Charges for excess value should be prepaid whenever possible, and are separate and distinct from the charges for excess weight.

Collections for excess value will *not* be made to any station or wharf beyond that to which the baggage is checked. [69]

* * *

(G) *Excess Value*—The shipper of baggage or other property permitted to be transported under this Tariff must, at the time of delivery to carrier, declare in writing the value thereof on form prescribed by checking carrier, as below:

Name of Carrier

Station .....(Date) .....19....

Valuation of Baggage

The property covered by Checks numbered ..... is valued at not exceeding $..... and in case of loss or damage to such property, claim will not be made for a greater amount.

Number of Passengers.....

Number of Tickets.....

(Signed) .....

Shipper:

Address .....

Baggage of excess value will be charged for subject to Tariff regulations.

If shipper declines to state the value of the baggage or other property on the form prescribed, shipment will not be accepted in baggage service.

[Endorsed]: Filed December 28, 1953. [70]

[Title of District Court and Cause.]

AFFIDAVIT OF BERNARD MITCHELL IN OPPOSITION TO MOTION FOR SUMMARY JUDGMENT

State of California,
County of Orange—ss.

Bernard Mitchell, being first duly sworn, deposes and says: That he is the Plaintiff in the above-entitled action, and was the owner, at all times mentioned herein, and in the Complaint on file herein, of a certain dog named "Pudsy." That said dog named "Pudsy" was a trained dog, used exclusively and regularly in the giving of theatrical performances, and in public entertainment, for both educational and entertainment purposes. That the Plaintiff was a resident of Northern Ireland, and a citizen of Great Britain; that for approximately two (2) years the Plaintiff had been regularly using said dog for the exclusive purpose of giving theatrical performances and [85] entertainments of both strictly entertainment and educational value in Northern Ireland. That said dog, "Pudsy," was called the "Wonder Dog of Europe" by the citizens of Northern Ireland, and was so known and stated

to be the "Wonder Dog of Europe" in the leading papers of Ireland and of England. That great things were predicted by way of the success of the wonder dog, "Pudsy," in the movies and in the entertainment fields in the United States. For this reason, and for the sole purpose of exhibiting the dog, "Pudsy," in the giving of theatrical and other public entertainments, the said Plaintiff, Bernard Mitchell, left his home in Ireland, and was in the process of bringing the dog, "Pudsy," to the State of California for the purpose of entering said dog in the theatrical performances and other public entertainments of the movies, television, and other forms of public entertainment in the United States and in California.

That said dog was of the value, to the Plaintiff herein, in the sum of One Hundred Thousand Dollars ($100,000.00). That the Plaintiff herein personally accompanied said dog, "Pudsy," on the boat from Ireland; personally watering, airing, feeding, caring for, exercising and training said dog at all times while on the ship to America. That from New York to Chicago, said Plaintiff was personally permitted to care for his dog, feed, water, and exercising the same at all times during said trip.

That the Plaintiff herein, being a citizen of Great Britain, and a resident of Ireland, was unfamiliar with the rules and regulations and customs, and manner of doing business, in the United States. That the Plaintiff herein was, at all times herein, amazed and bewildered by the difference in the ac-

tions, life, and manner of activity [86] in the United States. That said Plaintiff relied solely upon the advice and instructions of all persons he contacted in charge of transportation and other facilities in aiding him in bringing himself and his dog, "Pudsy," to Los Angeles, California.

That said Plaintiff herein was wholly unfamiliar with any rules or regulations relative to the transfer and carriage of himself and his dog, "Pudsy," while in the United States. That at all times the Plaintiff herein acted upon the assumption and advice given to him by persons connected with the railroads and other methods of transportation used in conveying him to California. That at all times mentioned herein, Plaintiff, Bernard Mitchell, was of the belief and understanding that the proper care, feeding, handling, and control of said dog, "Pudsy," would be handled by the railroad so conveying his dog, and that he was advised at all times, by the Defendants herein and their agents, that the dog, "Pudsy," would be given the proper care, feeding and watering, and that at all times mentioned herein, an agent would be in charge, and actually be in, the baggage car wherein said dog, "Pudsy," was to travel. And that, further, the Plaintiff herein would have access to said baggage car, and that he would be able to visit his dog at any time he desired. That said Plaintiff, Bernard Mitchell, is an immigrant to the United States for the purpose of residing in the United States, and of showing and using his dog for the purpose of theatrical performances and public entertainment;

and was never advised by the Defendants herein or their agents that he should make a valuation of said dog, and that the said Plaintiff herein was never advised that unless he paid an additional amount for additional valuation for the full value of said dog, or any other [87] value that he would be limited to the recovery of Twenty-five Dollars ($25.00), or limited to any other recovery for the loss of his said dog. That the Plaintiff herein was at no time advised that he could make a choice in placing a valuation. And that at no time herein was the Plaintiff advised, nor did he know, that he had a choice to place any valuation whatsoever upon his dog, "Pudsy," by the Defendants herein.

That said Plaintiff, Bernard Mitchell, has read the affidavit of E. B. Padrick, in support of the motion for summary judgment. That said Bernard Mitchell does not know said E. B. Padrick, and has no personal knowledge whatsoever as to the truth or falsity of the facts set forth in said affidavit. That the Plaintiff herein has, at all times mentioned herein, had no knowledge of a document called "The Western Baggage Tariff Number 25-13," issued May 12, 1948, effective June 15, 1948, as set forth in said affidavit, or in any manner whatsoever. That the Plaintiff herein has, at no time until seeing the said document called the "Western Baggage Tariff Number 25-13" attached to the Motion for Summary Judgment, had any knowledge that such document ever existed, and that said Plaintiff at no time has seen said tariff, and at all times mentioned in the Complaint had absolutely no knowledge whatso-

ever that such a document, containing any of the provisions therein, existed. That the Plaintiff herein was never advised by any agents of the Defendants herein, or by anyone at all, that such a document existed, and that said Plaintiff has never seen said document, and does know, even to this date, that the same is open to public inspection; has no knowledge where to find the same or to see the same, even at this date. That the Plaintiff has not seen, at [88] all times mentioned herein, any copy of said tariff posted anywhere, at any time.

That the said Plaintiff, Bernard Mitchell, has read the affidavit of C. E. Quackenbush. That the Plaintiff herein does not know said affiant, Mr. Quackenbush, or his position with the railway companies. That the Plaintiff herein at no time, while in Chicago or at any other place whatsoever or at all, was advised by any agent of the Chicago and Northwestern Railway Company, or any other person that there was such a thing as a baggage tariff number 25-13, and that the Plaintiff herein at no time was told that there was such a Western Baggage Tariff Number 25-13 open to inspection in the depot of the Chicago and Northwestern Railway Company, at Chicago, Illinois, on or about June 24, 1952, or at any other time whatsoever or at all; and there was barely time for the Plaintiff to transfer from his train going from New York to Chicago, to get on a train from Chicago going to Los Angeles, being the train "The City of Los Angeles." That the time was extremely short, and in a matter of minutes after the Defendant arrived at the train

station of the Defendants in Chicago, in which it was necessary for the Plaintiff to catch the train for Los Angeles. That it was not practical for the Plaintiff to look anywhere in said train station other than purchase tickets, and try and find the train that he was to get on. That the Plaintiff does not know to this date where in said train station, if at all, the said "Western Baggage Tariff Number 25-13" was posted. That the depot from which the Plaintiff left Chicago to come to Los Angeles was a powerful big station.

That the Plaintiff, Bernard Mitchell, has [89] read the affidavit of E. R. Foster; and that the Plaintiff does not personally know an E. R. Foster; but that the Plaintiff has read the affidavit of E. R. Foster, and specifically denies that on June 24, 1952, or at any other time whatsoever, at or about the hour of 5:40 p.m. of that day, or at any hour or time whatsoever, that the Plaintiff above named, Bernard Mitchell, came to E. R. Foster and stated that he, the said Bernard Mitchell, desired to check his dog through from Chicago to Los Angeles on the train known as the "City of Los Angeles," number 103, commencing that evening. Said Bernard Mitchell further specifically denies that he exhibited any passenger ticket whatsoever, entitling him to passage on said train. That the said Bernard Mitchell specifically denies that, in accordance with the provisions of the "Western Baggage Tariff Number 25-13," or any other provision of any other document or paper whatsoever or at all, that the said E. R. Foster asked the Plaintiff, Bernard

Mitchell, to make out the valuation slip required and saw him do so in his own handwriting. That the Plaintiff herein, Bernard Mitchell, has looked at a certain piece of paper; a photostat of a piece of paper, marked "Exhibit A"; to the affidavit of E. R. Foster, and said Plaintiff, Bernard Mitchell, specifically denies that he ever made or signed such a piece of paper, or printed statement. That said Bernard Mitchell specifically denies that he, at any time, wrote in the figure "25," in the line under the Plaintiff's statement, "is valued at not exceeding," as set forth in the affidavit of E. R. Foster. That said Bernard Mitchell specifically denies, and states that he denies, that he ever wrote out his name and address in the blank spaces farther down on the valuation slip, as set forth in "Exhibit A." That the said Bernard Mitchell further denies that the dog [90] was placed in a crate in the presence of the Plaintiff, and specifically denies that the crate and dog together were weighed and then placed with other baggage to be taken out and put aboard the train. That said Bernard Mitchell further denies specifically that E. R. Foster punched his ticket to indicate the baggage had been checked, and returned the ticket to him.

Said Plaintiff, Bernard Mitchell, further alleges, and states by affidavit herein, that he at no time executed or filled in the piece of paper marked "Exhibit A," attached to the affidavit of E. R. Foster. The said Bernard Mitchell further states that he at no time stated anything to the said E. R.

Foster, or any other baggage check clerk, as set forth in the affidavit of E. R. Foster, on file herein.

That the said dog, "Pudsy," was not carried as ordinary baggage under Plaintiff's ticket, but a separate charge was paid to the Chicago Northwestern System for the carriage of said dog named "Pudsy." That said dog, "Pudsy," was not baggage carried on a passenger train as free baggage, checked through on a passenger fare. That a fare of Eight Dollars and Thirty-three Cents ($8.33), was paid for the transportation of the dog, "Pudsy." That said dog, "Pudsy," was delivered to the Defendants in a strong crate fitted with a handle.

That the above affidavit has been read by the Plaintiff herein, Bernard Mitchell, and, under his oath, he hereby states that the same is true, to his own knowledge.

Dated: This 5th day of March, 1954.

/s/ BERNARD MITCHELL. [91]

The foregoing affidavit, consisting of eight (8) pages, including this page.

Subscribed and Sworn to this 5th day of March, 1954, before me, a Notary Public in and for the County of Orange, State of California.

[Seal] /s/ GEORGE H. CHULA.

[Endorsed]: Filed March 8, 1954. [92]
Affidavit of Service by Mail attached.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The motion of defendants, Union Pacific Railroad Co., a Corporation, and Chicago Northwestern Railroad Co., a Corporation, for summary judgment herein in favor of the plaintiff and against defendant Chicago Northwestern Railway Co., a Corporation, in the sum of Twenty-five Dollars ($25.00) only, came on regularly for hearing before the above-entitled Court in the courtroom of the Honorable Ernest A. Tolin, United States District Judge, on December 12, 1955. Plaintiff appeared by his attorneys, Monroe, Chula and Lines, by George H. Chula, Esq. The Court having considered the pleadings and affidavits on file and the depositions of Bernard Mitchell and Mrs. Bernard Mitchell and the evidence, and being fully [94] advised in the premises and finding that there is no genuine issue as to any material fact, makes the following findings of fact:

Findings of Fact

I.

That on June 24, 1952, at about 5:40 p.m., the plaintiff presented the dog "Pudsy" to Mr. E. R. Foster, Baggage Check Clerk employed by defendant Chicago North Western Railway Co., in the depot of said defendant at Chicago, Illinois, for checking as baggage to Los Angeles, California, on

the train "City of Los Angeles"; that plaintiff intended to travel on the same train and exhibited his ticket entitling him to do so to Mr. Foster; that Mr. Foster handed a "Valuation of Baggage" slip to plaintiff's agent, Mrs. Bernard Mitchell, who then and there, under authority of plaintiff, filled out said "Valuation of Baggage" slip declaring that the dog was worth Twenty-five Dollars ($25.00), and that in case of loss or damage to the dog, claim would not be made for a greater amount; that thereupon the dog was placed in a carrying case or crate and in due course was placed in the baggage car of said train; that one counterpart of Baggage Check No. 5114 was attached to said carrying case, and one counterpart of said baggage check was delivered to plaintiff; that when plaintiff attempted to feed and water the dog at Clinton, Iowa, during the late evening of June 24, 1952, he found that said dog was dead; that the death of said dog was caused by lack of ventilation in the baggage car, due to the negligence of the defendant Chicago North Western Railway Co., on the lines of which railroad all transportation to that point had taken place; that the defendant Union Pacific Railroad Co. was not connected in any way with the transportation or handling of [95] the dog.

II.

That prior to and on June 24, 1952, defendant Chicago North Western Railway Company had on file with the Interstate Commerce Commission and had printed and kept open to public inspection as

required by all applicable requirements of the Interstate Commerce Act and regulations and orders of the Interstate Commerce Commission, Western Baggage Tariff No. 25-13, which was the tariff applicable to the transportation of said dog; that said tariff provided that the limit of value on one dog, shipped in one crate, was Twenty-five Dollars ($25.00), in the absence of a declaration of an increased valuation and payment of a higher rate; that plaintiff did not declare any increased valuation of said dog, but, on the contrary, as set forth above, declared the dog to be of the value of Twenty-five Dollars ($25.00).

III.

That it was the intention of plaintiff to, and he did, represent to defendants that said dog "Pudsy" did not exceed Twenty-five Dollars ($25.00) in value; and that said representation was made with the purpose, intent and result that the defendant Chicago Northwestern Railway Co. believe and accept said valuation of said dog "Pudsy" to be not to exceed Twenty-five Dollars ($25.00).

From the foregoing Findings of Fact the Court makes the following Conclusions of Law:

That plaintiff is estopped to assert against defendants that said dog "Pudsy" had a value in excess of Twenty-five Dollars ($25.00);

That plaintiff is entitled to judgment against [96] the defendant Chicago North Western Railway Co.,

a Corporation, in the sum of Twenty-five Dollars ($25.00), together with his costs of suit incurred herein taxed at $.....

Dated: This 16th day of December, 1955.

/s/ ERNEST A. TOLIN,
United States District Judge.

[Endorsed]: Filed December 16, 1955. [97]

In the District Court of the United States, Southern District of California, Central Division

No. 15634-T

BERNARD MITCHELL,

Plaintiff,

vs.

UNION PACIFIC RAILROAD CO., a Corporation; CHICAGO NORTH WESTERN RAILROAD CO., a Corporation, et al.,

Defendants.

SUMMARY JUDGMENT

The motion of defendants Union Pacific Railroad Company, a corporation, and Chicago and North Western Railway Company, a corporation, for summary judgment herein in favor of the plaintiff and against defendant Chicago and North Western Railway Company, a corporation, in the sum

of Twenty-five dollars ($25.00) only, came on regularly for hearing before the above-entitled court in the courtroom of the Honorable Ernest A. Tolin, District Judge, on December 12, 1955. Plaintiff appeared by his attorney, George H. Chula, Esq., and said defendants appeared by their attorney Malcolm Davis, Esq. The court having considered the pleadings, affidavits and depositions on file and the concessions and stipulations of counsel,

Now, Therefore, It Is Adjudged and Decreed that the plaintiff have judgment against the defendant, Chicago and North [98] Western Railway Company, a corporation, in the sum of Twenty-five Dollars ($25.00), together with his costs of suit incurred herein taxed at $.....

Dated: December 16, 1955.

/s/ ERNEST A. TOLIN,
District Judge.

Affidavit of Service by Mail attached.

[Endorsed]: Filed December 16, 1955.

Judgment docketed and entered December 19, 1955.

[Endorsed]: Filed December 28, 1953. [99]

[Title of District Court and Cause.]

NOTICE OF APPEAL TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

To the Union Pacific Railroad Company and to the Chicago North Western Railroad Company, and to E. E. Bennett, Edward C. Renwick, Malcolm Davis, Jack W. Crumley, and Donald M. Ladd, Jr., 422 West Sixth Street, Los Angeles 14, California, Attorneys for the Defendants:

Notice Is Hereby Given that Bernard Mitchell, the Plaintiff in the above-entitled action, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the Summary Judgment entered in this action on the 19th day of December, 1955.

MONROE & CHULA,

By /s/ GEORGE H. CHULA,
Attorneys for the Appellant,
Bernard Mitchell.

Affidavit of Service by Mail attached.

[Endorsed]: Filed January 18, 1956. [101]

[Title of District Court and Cause.]

MOTION FOR EXTENSION OF TIME WITHIN WHICH TO FILE RECORD ON APPEAL AND DOCKET APPEAL

Comes Now the plaintiff in the above-entitled cause and moves the court for an order extending the time within which the plaintiff shall file the record and docket the appeal upon his Notice of Appeal, filed January 18, 1956, for the following reasons:

Appellant was unable to make arrangements for and file his costs bond on appeal until February 3rd;

The Reporter's Transcript of Proceedings on December 12, 1955, a copy of which, under Rule 75 of the Federal Rules of Civil Procedure, must be filed with the designation of the contents of record on appeal, was received from the court reporter last week and since receipt of the transcript counsel has been unable to come to Los Angeles to examine the files for the purpose of preparing the Designation of Contents of Record on Appeal but will do so within the next day or so;

Under the Federal Rules of Civil Procedure the appellee has ten days within which to serve and file a counter-designation of any [106] additional matter to be contained in the transcript of record and the Clerk of this court will require some time after all the designations are on file within which

to prepare the transcript and transmit it to the Court of Appeals in San Francisco;

It will be impossible to comply with all of the rules and have the appeal docketed by February 27th, the last day now fixed for filing the record and docketing the appeal;

Wherefore, Plaintiff-Appellant moves the Court for an order extending the time to file the record and docket the appeal for an additional twenty days from and after February 27, 1956, to wit: March 19, 1956.

MONROE and CHULA,

By /s/ GEORGE H. CHULA,
Attorneys for Plaintiff-Appellant.

ORDER

No Cause Appearing From the Foregoing Motion, but as an Act of Courtesy, It Is Hereby Ordered that the time for filing the record and docketing the appeal in the above-entitled cause be, and it hereby is, extended to and including March 5, 1956.

/s/ ERNEST A. TOLIN,
Judge, United States District Court.

[Endorsed]: Filed February 24, 1956. [107]

In the District Court of the United States, Southern District of California, Central Division

No. 15634-T

BERNARD MITCHELL,

Plaintiff,

vs.

UNION PACIFIC RAILROAD COMPANY, a Corporation; CHICAGO NORTH WESTERN RAILROAD COMPANY, a Corporation, et al.,

Defendants.

DEPOSITION OF BERNARD MITCHELL

the plaintiff herein, taken on behalf of the defendants, at 2 p.m., Tuesday, June 29, 1954, at 422 West Sixth Street, Los Angeles 14, California, before Edward A. Oreb, a Notary Public within and for the County of Los Angeles and State of California, pursuant to the annexed stipulation.

Appearances of Counsel

For Plaintiff:

MONROE & CHULA, By
GEORGE H. CHULA, ESQ.

For Defendants:

E. E. BENNETT, ESQ.,
EDWARD C. RENWICK, ESQ.
MALCOLM DAVIS, ESQ.,
JACK W. CRUMLEY, ESQ.,
DONALD M. LADD, JR., ESQ. By
MALCOLM DAVIS, ESQ.

Mr. Chula: One thing that I want to point out, Mr. Davis, before we start, and this might save some time, there is a question here on Paragraph 8, and I have alleged in drawing up the Complaint that the plaintiff has gone and filed for more money, and that through use of the dog has received large amounts of money and publicity and so on. I want to point out in speaking about the money part for this man in Ireland, which later will be brought out, that actually he didn't receive money himself. He donated it back there. He refused the taking of the money that would be offered to him and donated the donations himself, and that is where I had some confusion in drawing it up. I think it wouldn't be fair to them, alleging one thing and another. I thought that should be in the record and we can clarify that, if necessary.

BERNARD MITCHELL

the plaintiff herein, having been first duly sworn, deposed and testified as follows:

Direct Examination

By Mr. Davis:

Q. Now, we are going to take your deposition, and by that is meant that although we are taking it informally in my office, that nevertheless it has just the same effect [2*] as if we were in the courtroom. A. Yes.

Q. Now, everything we say will be taken down by the Reporter and reduced to typewritten form,

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

(Deposition of Bernard Mitchell.)

and in that form you will have the opportunity to read it over and at that time you may make corrections in the deposition to make it speak the truth. Then after you have done that you will sign the deposition as being your testimony in the action.

Now, if you make corrections in the deposition, I have the right to ask you to make explanations as to why you made them. So when you make corrections, please have in mind that you may have to explain that fact later on. Do you understand this thoroughly? A. Yes.

Q. Now, as I understand it, you are the plaintiff in this action of Bernard Mitchell versus the Union Pacific Railroad Company, a corporation, and Chicago Northwestern Railroad Company, a corporation, et al.? A. Yes, sir.

Q. And that is on account of the death of the dog Pudsy? A. Yes, sir.

Q. Now, are you a citizen of Ireland?

A. Yes, I am.

Q. But you are now a resident in the State of California? [3] A. That is right. Yes.

Q. Where do you reside at the present time?

A. At the present time I am right now at Euclid Avenue.

Q. What number?

A. 12572 Euclid Avenue.

Q. What town?

A. Garden Grove, California.

Q. Are you renting that place?

A. Yes, I am renting at that place, yes.

(Deposition of Bernard Mitchell.)

Q. Now, I take it you were born in Ireland?

A. Yes.

Q. Where did you live for some considerable period of time before you came to the United States?

A. I lived at 23 Edwards Street, Lurgan County, Armagh, Ireland. That is Northern Ireland.

Q. Was that your birthplace? Did you live there since your birth?

A. I wasn't born there, you see.

Q. For how long did you live there?

A. I lived there from—how long? We was seven years there, roughly.

Q. What was your occupation there?

A. I was a sack and bag merchant.

Q. Sack and bag merchant?

A. Yes. [4]

Q. What do you mean by that?

A. Well, I bought sacks, empty sacks and sold them, you see, and collected sacks around the country from the farmers. You would call them jute sacks.

Q. Some time before you came to the United States, you got this dog Pudsy?

A. Yes.

Q. That was a gift from a friend?

A. Yes, that is right?

Q. Now, who was the friend?

A. Well, the friend's name—I think the friend —the people that gave it to me have left us now.

(Deposition of Bernard Mitchell.)

They are dead, of course. I just can't recall the name right now.

Q. You say they are dead?

A. Yes, I think they are. I don't think they are living.

Q. Well, they weren't very good friends, I take it, then?

A. What do you mean by good friends?

Q. Well, a friend whose name you would remember very easily now.

A. Oh, well, no, they wouldn't be blood relations, if that is what you mean. Just an ordinary friend to speak to or to talk to, that kind of friend.

Q. When did you get Pudsy?

A. Well, about 1947, I think, late fall. [5]

Q. Now, as I understand it, you had had no training in the training of dogs before that, had you?

A. Well, at my place, you see, we always kept animals. You see, we are reared up with them, donkeys, ponies. We kept cattle, too. Cats and dogs and we kept all that. I was reared up with them. My experience with training dogs, this was my first dog that I had got for my own, you see.

Q. Well, had you trained any other dogs before that?

A. No, not for actual training purposes.

Q. Well, as I understand it from your answers to these interrogatories, nobody had ever taught you how to train a dog, had they? You had no education along that line, had you? A. No.

(Deposition of Bernard Mitchell.)

Q. Well, then when you got Pudsy, just tell us what you did about training him.

A. Well, you want to go into detail?

Q. Well, a little bit. Let us see how far we get.

A. Well, the first thing I brought the dog home, you see, a little pup. I came home with it. When I came to my home, there was a clergyman present in the house. He had been visiting us. He was just from the missions from Africa. He was out on the missions and knew my wife here. I came in with the dog. He says to me, "What is that you have got?" I says, "Father, that is a little pup. A little [6] dog." He says, "Bernie, have you got a name for it? What do you call it?"

"Well," I says, "got no name yet. I just got it. Just bringing it in."

He says, "Well, I will give it a name."

I says, "Father, whatever name you give that dog, I am going to call it. I don't care what the name is. Once you mention it, I am going to call that dog that name."

Well, he began to think it over.

Q. Well, we are getting into too much detail.

A. Well, that is how it got its name. It is a name. I am only going to tell you how he got his name.

Q. Well, O.K.

Mr. Chula: He wants to know how you trained it and what you did.

The Witness: I will come to that after getting over the dog. I want to get first how it got its

(Deposition of Bernard Mitchell.)

name. There was hundreds of people who asked me how this dog got this name.

Q. (By Mr. Davis): I am sorry I interrupted. Go back to where you were.

A. He says, "I will give it a name." He says, "Call it Pudsy." I says, "All right, Father, I will call it Pudsy." That is a character in the Far East. That is how the dog got its name. So we were talking some more, just at tea. [7]

Q. What kind of a dog was it?

A. It was a fox terrier.

Q. What was its color?

A. Black and white.

Q. What portions were white and what portions were black, do you remember?

A. Well, a black spot on his back; he had a black head. You see, he was—he had two little dots on his head here, as the photograph—I will show it to you.

Q. All right. Tell us how you went about training the dog.

A. Well, here is how I went about it. I was always ambitious for the training of an animal and doing something with an animal on my own, you see.

Q. By the way, how old was the dog when you got it? A. It was about six weeks old.

Q. Well, now, just tell us what you did; never mind your ambitions. Tell us what you did.

A. The first thing I looked at the dog and examined him, you see, and let him set down for a while. I looked at his head and I said, "That boy

(Deposition of Bernard Mitchell.)

has intelligence in there. All it wants to need is to bring it out." He had a wise head, you see. He began to know how to do things in no time. I told him to go out and he went out. I told him anything, you see. If he had messed any place, I said "Don't do that any more." And he wouldn't have done it. I began to [8] see this was intelligence in this dog. So I got down into the training. I said, "Well, I am going to bring it out of him. It is there. All it needs is to come out."

So nobody in the house, only myself, you see, just the two of us, whenever I was there on my own, I closed all the doors and let that dog into the kitchen, you see, and I began to teach him. I was teaching him first how to sit up, how to beg and teaching him how to lie down. I taught him to sit up and say his prayers with his paws up like that (indicating), you see. Well, I just started with that, you see. Then as he got on, you see, I didn't give too much at the beginning. I let him settle down. When he got that trick well off, then I trained him to do another one. As he was growing, he was getting wiser. And then I learned him more tricks. I learned him how to close the door. I had to come through the door and I said, "Pudsy, go and close that door." Pudsy went over and closed the door. And when he came back, of course, I patted him and a little tidbit, you see.

I was sitting and smoking a cigarette; purposely I put it down on the floor, and the dog was sitting there. I pay no attention to him. I looks at the dog;

(Deposition of Bernard Mitchell.)

I says, "Pudsy, are you going to let this house burn down? Put that cigarette out." So he gets up and puts the cigarette out. He shakes it with his mouth and tromps on it with his paws, and I said, "That is a good boy." Another pat and a little [9] sweet tidbit. He never did anything that I didn't repay him. That is the way I trained him at my house.

I would ask him how would he like to come for a walk. I says, "Let's go for a walk. Where is your strap? Let us get your strap and let us go." He would get the strap.

Then I learned him, you see, to go over my back at home, you see, and through me arms and to sit up and do anything at all. I learned him how to count the spots on the cards. In a five-spot or ten spots, I would say, "Tell me how many spots on there. If there were ten spots, he gave ten barks. Five spots, five barks.

I learned him how to do sums. I said to him—I learned him to count first. Then I learned him to do sums. I asked him sums such as, "How much is six and two?" I would ask him that and he would give eight barks. I said, "Two and two?" And four barks.

Well, I give him a little tidbit. And then after that I got him well onto that and I began to give him dividing sums. For instance, four into sixteen and two into eight and four into twenty and three into twenty-one, and I would test him. I said, "Pudsy, tell me how many fours into twenty?" Five barks. "Well," I said, "that is good."

(Deposition of Bernard Mitchell.)

I said, "Well, I will try better still. I am going to learn him now—" I learned him how to subtract away; for instance, three from eight, four from seven, three from eleven. I would say, "Three from eight"; five barks. Well, [10] then I would say, "Three from six"; three barks.

Of course, I always gave him something.

Well, then, a reporter came down from the local newspaper, and he heard about the dog, so I put him through all that for the reporter.

Q. When was that? A. That was in——

Q. Is that when you——

A. Yes. You can see it in that post, that is when the reporter came down.

Q. Now, I am showing you a clipping that was attached to your interrogatories, and that shows a clipping from the Lurgan and Portasdown Examiner dated April 28, 1951; is that right?

A. Yes, that is right.

Q. Now, up to that time had you exhibited the dog in public at all?

A. Yes, I had. I had before he came down. Yes, I had done a few shows. Yes, I had done a show in Rith Friland. I did a show there with him, and I did a show in the next place to that in Gregory.

Q. Now, when did you give those shows?

A. Well, that was just—that was before this man here came down.

Q. How much before?

A. I would say about—I would think three or four [11] months before that.

(Deposition of Bernard Mitchell.)

Q. Well, when you say you gave a show, where did you give those shows?

A. In the Parish Hall—in a hall.

Q. Parish hall? A. Yes.

Q. Was there an audience present?

A. Oh, yes.

Q. How many people?

A. It was all full, packed.

Q. About how many?

A. Oh, let's see. I would say there was between three and four hundred that was there.

Q. How much did you charge for admission?

A. Oh, yes, the people who had the hall charged admission.

Q. How much?

A. Admission, I think it was two and six to get in.

Q. How much was that in our money?

A. That wouldn't be very much in your money. That would be—I don't know how you figure that in your money.

Q. Two and six is two shillings and six pence?

A. That is right.

Q. We will say about 12 cents or something like that? A. Yes.

Q. 12 and half cents? [12] A. Yes.

Q. Then six pence is half a shilling?

A. Half a shilling, that is right.

Q. So it would be about 32 cents altogether, then?

(Deposition of Bernard Mitchell.)

A. I suppose you would kind of call it that.

Q. Well, what happened to the money?

A. Well, what happened to the money there, the people in charge of the hall run the show, you see. They started to give me my money and I said to the man to give it to charity.

Q. Well, did all the admissions go to the church?

A. Yes.

Q. You didn't get any?

A. I was asked for my fees. I could have charged them, but, you see, I put my fee into the charity.

Q. Did you actually charge a fee?

A. Yes, I charged.

Q. How much? A. It was accordingly.

Q. Well, in those two places, what did you charge?

A. I left that to their own decision, their own decency, you see. They always treated me—gave me more money than I charged.

Q. Did they give you any money?

A. Well, they offered me, you see.

Q. What did they offer you? [13]

A. Anything I said, the price.

Q. Well, what did you say?

A. I said, "Whatever is fair. I don't want to go too hard with you."

Q. What amount of money was agreed on?

A. Well, you see, it was just whatever I would ask.

Q. Well, what did you ask for on those two

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shows that you gave before you saw the reporter? What figure was it?

A. Well, it was a little figure because I left it to them, whatever they thought it was worth.

Q. Well, didn't they ever tell you what they thought it was worth?

A. I said, "Whatever you think I am entitled to for the show."

Q. What did they tell you?

A. Well, that is a hard thing to remember right now. They didn't tell me. It was a charity affair and social affair. I never cared much about prices.

Q. Well, you never came to any agreement as to what your fee might be; is that it?

A. No, we never came up to anything like that.

Q. Well, anyway, you wouldn't have taken the money; you would have given it to the church and you just told them to keep it? Is that right?

A. Yes, that is right. [14]

Q. Well, after the reporter came down to see you on this date of April 28, 1951, did you show the dog some more?

A. After the reporter, yes.

Q. Where did you show him and about how many times?

A. I showed him in a place called Derry Macash Hall.

Q. Where was that?

A. Outside Lougan, about three miles outside Lougan.

Q. When was that?

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A. Well, you see, that was sometime after that reporter came down. I don't know exactly the date.

Q. Do you about the date?

A. Let me see now. It was about a month or so after that.

Q. All right. Did you show him again?

A. Yes, I showed him again at Newry, in the town hall of Newry. I showed him there.

Q. When was that?

A. That was after this other show here at Derry Macash Hall.

Q. Well, about how long?

A. This isn't exact. It is pretty hard to give you exact details. This is just roughly.

Q. Well, that is all I am asking you for is your best recollection.

A. Well, a couple of months after that. It was about two months after that. [15]

Q. Did you show him any more? A. Yes.

Q. Just tell me about it, will you?

A. I brought him from Newry and I did a show with him in my own home town, Forrester's Hall. I done a show with him there, and then I done a show in Lurgan, Lurgan's town hall. I done a show in the Convent of Mercy, Lougan, for the children on the playground. I done a show then in Lougan in St. Joseph's Hall. Then a lot of people came into the home to see him, you see, in between these things. They heard about him and came to see the dog personally. They came from all around the country to see him.

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Q. Well, do you remember any more shows that you gave?

A. Yes, I done a show in the Textile Hall and we did a show at the Union Hall in Lougan. I done a show there. I done a show for the Sisters of Mercy in Lougan, too. The nuns, I done a show for them. That is as far as I can remember right now, you see.

Q. Yes. Well, if you remember any more, you can put those in the deposition when you sign it.

A. Yes.

Q. Did you get any money yourself from any of those shows?

A. Well, the money that had been given to me, I donated to charity.

Q. All of these places were in charitable institutions, [16] were they not? A. Yes.

Q. Churches and the Union Hall and so on?

A. Yes.

Q. So you would show the dog in order to raise money for the organization that owned the hall; is that it? A. Yes, that is it.

Q. I see. Well, was there any fee ever fixed for your services in showing the dog?

A. No, I can't recall of any, you know.

Q. Well, now, when did you start for the United States?

A. Well, I started in June. I left my home town in Ireland about—I landed in the United States on the 13th of June, in New York.

Q. When was that?

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A. 1952. That was two years ago.

Q. Now, how did you happen to come to the United States?

A. I came to show my dog on television and make pictures with him in Hollywood and also to display him to all the children of the United States, which I displayed to all the children in Ireland, of the kindness that can be done.

Q. Did you have any purpose in coming, too?

A. No, that was my sole purpose. [17]

Q. What was it that made you believe that you could get him in television?

A. Well, we had no television in Ireland, and I knew this was the country for television and also the country for anything like that part of it.

Q. Well, did you have any contract with anybody?

A. Well, I was to meet people, you see, when I would arrive.

Q. When you were to arrive where?

A. In Los Angeles, with the dog.

Q. Whom were you to meet?

A. Well, my wife knew some friends in Hollywood. She knew Mrs.—Bob Hope's wife and there was a few more friends. Well, I was in with contacts, too.

Q. Were you to make those contacts after you got here or did you have correspondence before you came over?

A. Well, I would have to bring the dog over first. I would have to arrive with the dog first. I

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would have to let them see the dog and prove to them that he was the dog.

Q. Let's see. You lived in North Ireland, didn't you? A. Yes.

Q. And you left from Cobb, you say?

A. Yes.

Q. Where is that located? [18]

A. The southern part of Ireland.

Q. How did you get there? A. By train.

Q. How did you transport the dog on the train?

A. I was given permission to have the dog beside me on the train from Belfast to Cobb.

Q. That is right in the passenger compartment?

A. Yes, right there beside me. Right beside me.

Q. You did take him that way?

A. Yes, I did the whole way.

Q. Did you have him on a leash?

A. Yes, on a leash.

Q. But not in a crate? A. Not in a crate.

Q. You and your wife and the dog were the only ones in the party, I take it; is that right?

A. Yes, that is right.

Q. All right. You got to Cobb and you took the Mauretania to New York; is that right?

A. Yes, that is right.

Q. Now, how did the dog get around, then, on board ship?

A. Well, before I took him on board I was consulted by, I think, one of the Cork newspaper representatives, who was right there looking for me. He seen me coming up.

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Q. What representative? [19]

A. One of the Cork papers.

Q. Cork newspapers?

A. That is in Cork. That is in the City of Cork. He asked me, "Is this the famous dog?" I says, "Yes, that is him." He says, "You are for the United States?" I said, "Yes, I am going to the United States."

He says, "Is he going on television?"

I says, "Yes, he is going to make pictures and be on television."

He says, "Aren't you the trainer and owner?"

I says, "Yes, I am the sole trainer and owner."

He said, "Well, don't mind me stopping you."

I says, "It is all right."

He says, "I am the reporter for the newspapers and I have to put this in the paper." He wished me luck and I went on through to the boat.

When the boat was leaving, there was some friends that took me down to the boat at Cork, you see, and I was on the boat and it was leaving. So I told the dog to sit up on the bench on the boat and I said to the dog, "Pudsy, give them the last farewell barks before you leave the Old Country." So Pudsy barks. He barks three times, one, two and three, and I shook my hand and we went on out. I landed with the Mauretania. I brought my dog up to the people in charge. I don't know what they call them, in charge of the boat. I handed me dog over. I said, "Can I be able [20] to see him and look after my dog and give him care and give

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him anything he wants and will I be able to see him any time?"

I was told—I got permission at any time of the day or night to go in and to see that dog. I could have went in any time on that ship while the boat was on the ocean and bring the dog out onto the deck and give it exercise and bring it in again.

Q. Where was the dog to stay?

A. A special place they have with kennels so they can keep animals. The butcher, he was called the butcher, was in charge of them. They were on the lower deck, you see, apart from the passengers' side, where they kept animals with other dogs. The butcher was very good to him. He got right on friendly with the butcher and became great friends. He says, "That is a good dog. Bring him right out any time." So we—well, word got around the boat that he was a trick dog. They had a concert on the boat, a children's concert on the boat. The purser came along to me and he approached me and he says, "I want you to bring your dog over and give the children a concert." He says, "I am having a concert with the third class up to the first class compartments." He said, "Will you come up with your dog?" I said, "Sure. I will be glad to give a concert for the kiddies." He said, "Tomorrow we are having the concert. Bring your dog up." I brings me dog up. The kiddies [21] were all right on the top deck, first class compartment. I took a blackboard and got my chalk out and wrote sums on it. I told the children all to sit

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down. I cannot tell you exactly what sums, but I wrote sums on it. I think there must have been three and four and two and three and two and two, something like that, and I wrote them sums on the board and I pointed to the first kid. I always tried to divide the boys and girls on different sides. So I went to him and I said, "Now, could you tell me how many two and two makes?"

"Yes, two and two is four."

"Now, I am going to ask Pudsy to tell you how many two and two are." So Pudsy was sitting up in a little chair, and I said, "Pudsy, will you tell this little lady here how much two and two is?"

Pudsy barks four times.

I said, "Is that all right?"

Big clapping. I turns over and said to the little boy, "Would you like to ask him one?"

"Well, could you tell me how many three and three are?"

"All right. I will tell him for you. Pudsy, tell this little boy how many three and three are." Six barks.

Now, then, I said—I held up my hand and asked how many fingers I had on one hand. They all shouted, "Five."

"Now, I am going to ask my dog how many fingers I have got on my hand." [22]

I said, "Pudsy, how many fingers have I got?"

Five barks.

I said, "How many fingers am I showing you now? Can you tell me?"

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They said, "Seven."

"I am now going to ask the dog to tell you. "Pudsy, tell them how many fingers there are."

Seven barks.

I done all the tricks then, which I just can't recall, and the purser came along there and thanked me very much and was much obliged for my coming along with the dog and the dog show. So I had the show for the big people for all the ship, all the big people on board the ship. I think it was the following night. So I was brought up then to the purser to do the show on the boat. Well, I suppose it was on the salon. There was a great big place down there and all the people on board the boat was invited down to that place. I brought the dog there to do the dog tricks and put the cards out. I show them to the people in the room and asked them—I cannot tell you exactly what card it was, but I think one of them was a seven. I said, "Now I am going to ask Pudsy to tell us how many spots there are on the card. Pudsy, you tell these people how many spots are on this card." He barked seven times.

I done more tricks. I put three pieces of cake down. I said, "Now, I am going to tell the dog to take one piece." [23]

I put some down and the dog was sitting on the chair. I said, "Pudsy, go and take one piece of cake."

The three pieces were close together, right close

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together. So Pudsy comes and takes one piece and comes back and sits on the chair.

I said, "Pudsy, go and take another piece. Leave one."

So he goes and he takes the other one. So I told him, "Go and take the last one." And he goes.

Then I said, "Anybody that wants to come up for to test the intelligence of this dog in obedience, I will offer this cake to you. Before you give it to him, I will give him a piece of it and then you give him that piece there. I will tell him not to take it off of you. I am going to tell him not take it off you."

I said, "Anybody can come up." So I don't know, I can't recall now who volunteered on that, but I said, "The dog will do it." I said, "To prove this—" I put the cake down on the floor. I said, "Pudsy, don't be taking that cake until I tell you to take it." The dog is just sitting there. He didn't touch it.

I said then, "Go on, take the cake." He goes and takes it. I am not sure whether it was the purser or the butcher here that offered the cake to the dog, I am not sure which.

I said, "Put him to the test."

Pudsy wouldn't take the cake. I said, "Pudsy, go and take the cake off him." So he goes and takes it. [24]

After that I could have gone up and down the boat with him any place and got all the facilities. I could go in any time at night to see him. I used

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to go at night before I retired to see if he was all right and up in the morning to see if he needed anything.

Q. Were you paid anything for those shows?

A. No, nobody paid for anything. No, it was just on account of the Mauretania, you see, and the staff.

Q. Well, all right. You got to New York. Now, did you have your railroad tickets to Los Angeles? Did you buy those in Ireland or did you get those in New York?

A. No, we got our tickets for ourselves from Belfast to Los Angeles and all they would give us was tickets, that is, for the dog, was to New York. They said they never shipped a dog.

Q. How did you get the dog and yourselves on the train in New York?

A. Well, we went down in a taxi to the station. We went into the office. I inquired about the dog. I told them this was a very valuable dog and I wanted to know all about the shipment. I never put him on this train before, so I wanted to know.

Q. This is the baggage room, is it?

A. Yes, it must have been. There was a man at the counter taking charge of orders. I asked him, "Can we be able to get on this train with him? Will I be able to get [25] in beside this dog, as he goes along. Can I go in with him whenever I want to?"

He said, "Yes, you will."

I said, "Is that right?"

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He said, "Yes, you will be putting him in there and your seat will be pretty near the dog, so you won't have to walk far."

Q. They wouldn't let you have the dog on the car with you?

A. Well, not at that station. It finished up that the dog—Well, I will go on with my story. You see, I want you to get the whole story, actually. I know it is pretty long, but that is the way with all the details.

So the dog went on the train. I went in there and there was a man inside that wagon. I give him my dog. I says to him when I was giving the dog to him, "That is a very valuable dog. Can I get in to see him? That is a trick dog."

Well, then, he said, "Yes. Any time at all."

I said, "That is all right." So I give him the dog. So I comes right up again and gets in the carriage and sits down. I look down and the door of the baggage car was wide open. I see that Pudsy was sitting down there. I goes down and pats him. I said, "What is it? Pudsy, you are quite safe here."

I said, "Is this where he will be? Can I get in and [26] out? I know I am asking you so often, but I want to know before you close this door."

He says, "No, you can get in and out. That door will not be closed." He said, "You can get in and out."

So the dog went on ahead. I don't know the time, and the man came out to me and he says, "I been on this railroad a long time and I never seen any

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dog like that dog. That dog is no trouble. He never gives no trouble. He hasn't given a bark or any kind of disturbance." He said, "I tell you, you take him out if you want to and let him sit beside you."

Q. How long was that after you started?

A. A long time. It was a long trip from New York to Los Angeles. It was quite a long while. I couldn't tell you how long. So he allowed the dog to be out with me. He says, "Bring him out with you." I bring him out on the seat. He said, "Sure. That dog you can bring anywhere. He gives no trouble."

I brought him out on the seat and he sat beside me. The checker came up the train and he sees the dog and passes by. And then a time after that he comes up the train again. Some people had got on the train and had objected to the dog sitting beside me to the ticket man, and he says, "This dog had traveled," he says, "from New York and has given no trouble, either beside him or in that baggage car," he says, "so I can't put him off. He is sitting there. There is no [27] complaints and no disturbance." He says, "He is just sitting there, and I see no reason to put that dog off."

He came down to me and said, "Do what you like."

Q. The dog rode with you to Chicago?

A. Oh, all the way he rode to Chicago with me, yes.

Q. Well, now, going back to New York, didn't

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you have to sign an evaluation slip in order to get the dog on the train, like this slip here that I show you, this valuation slip?

A. No, I don't remember seeing that.

Q. Didn't you get a baggage check?

A. Check? What kind of check is that?

Q. Well, it would be something like this (indicating).

A. Yes, I imagine I got something like that. I imagine I got a check or something.

Q. Now, at the time you got that check, didn't you sign this valuation slip?

A. No, I didn't sign any valuation in New York at all.

Q. Did your wife sign one?

A. I couldn't say.

Q. Were you both together in New York in the baggage room? A. Yes.

Q. And with the dog?

A. Yes. The man kept telling me all the time while [28] he was writing, "Don't forget and tell me," he says, "whenever you are on television with this dog. I want to get my kiddies up to the television and tell them I shipped that dog for you." That is what he said to me.

Q. You don't remember signing any slip of any kind? A. No.

Q. Did you sign anything there?

A. No, I can't recall.

Q. Did your wife sign anything there?

A. I couldn't say.

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Q. Well, you were right together, weren't you?

A. Well, I don't know. I couldn't say for sure whether she was or not.

Q. Well, did you have a crate for the dog in New York? A. Yes.

Q. You put the dog in the crate? A. Yes.

Q. Was it in the crate in the baggage car?

A. Yes, for a time.

Q. How did you come to buy the crate?

A. Well, I inquired in New York from a friend—well, he wasn't a friend, just a person whom I was talking with, but I asked, "Where can I get a dog crate?"

He told me, "Downtown," he says.

Q. How did you happen to get a dog crate? How did you know that you needed a crate? [29]

A. They told me for shipping.

Q. Who told you?

A. This person, you see. The people I was with in New York just stopping at.

Q. Just friends?

A. Just friends, yes. They told me I would have to get a crate, because I had no crate coming from Ireland. We didn't use any crates in Ireland.

Q. So you got a crate?

A. Sure. So I got a crate.

Q. You took the dog up to the station, Grand Central Station? A. Yes.

Q. And went into the baggage room. Was the dog in the crate when you went into the baggage room?

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A. No, I walked into the Grand Central Station with the dog on a leash and the crate in one hand, and the dog goes over to the——

Q. You went over to the baggage room?

A. It wasn't a room. Just a big counter along the platform with a man behind it.

Q. There were bags and things behind it?

A. Yes.

Q. Did you put the dog in the crate?

A. Where?

Q. At the counter. [30] A. At New York?

Q. Yes, at New York.

A. Yes—No. I said, "What is the procedure? What have I to do?"

Q. Never mind the conversation. What did you do?

A. I brought my dog on right down, you see.

Q. Where? A. To the baggage car.

Q. On the train? A. Yes.

Q. You still had him on a leash?

A. Yes.

Q. You had the crate under the other arm?

A. Yes.

Q. You took him right down to the baggage car?

A. Yes. So I takes him out to the baggage car and the man in charge there, I think he said, "He has to go in the crate."

"O.K.," I says, "put the dog in the crate."

Well, he look at him. He says, "He seems quite all right. I don't think it will be necessary to keep him in this crate."

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I says, "He is nice. I will be here and I will be in there."

And he says, "That is all right."

Q. Did he stay in the crate? [31]

A. Not very long. I think he says, "Well, just put the leash on him. Tie the leash there. That is sufficient for that dog," he says. He says—and I says, "There is the crate there anyhow, if you need it."

Q. And you left the crate there? A. Yes.

Q. Where was this? Was there any check put on the crate?

A. Well, I couldn't say if there was a check on the crate or not.

Q. Or a check on the dog? A. Well, I——

Q. You remember getting one part of a check, don't you? A. Yes.

Q. Then how about this other part with the string on it?

A. I think that must have been tied on the crate or something.

Q. Well, was it on the crate?

A. Well, now, when I come to think of it now, I think it was on the crate.

Q. Well, it should be.

A. Well, you see, it is quite a time element since it happened, you know.

Q. All right. Then when you got to Chicago, the dog [32] was with you? A. Yes.

Q. Where was the crate at that time?

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A. The crate was in the baggage car.

Q. All right. When you got off at Chicago, did you get the crate out of the baggage car?

A. I got the crate.

Q. You had to change to another station, didn't you? A. Yes.

Q. You went over there by taxi, I suppose; is that right? A. Yes.

Q. About what time did you get to Chicago?

A. Well, now, it was Eastern Time and summertime back East.

Q. Well, about what time of day?

A. Let me see now. Oh, I suppose it was about around half of 4:00 and 5:00, I think, I am not sure.

Q. How long did you have to wait for the other train?

A. Well, the only thing I think is that it was leaving shortly after 6:00.

Q. You had about an hour and a half altogether in Chicago; is that right?

A. Not an hour and a half, no. I think it was—well, we had a taxi, you see. It was all arranged. So many people going on the train and the taxi was bringing people [33] back over here and I would say 10 or 15 minutes at the Chicago Station after getting off the New York train before we landed over there. Then it took about a few minutes to go by taxi over to the Chicago Station.

Q. Then when you took the taxi over, did they put you out by the baggage room?

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A. No, they left me on the side of the station, you see, inside.

Q. Oh, I see.

A. Where all the people get off.

Q. And the dog came with you? A. Yes.

Q. On the leash? A. Yes.

Q. You had your crate under your arm?

A. Yes.

Q. Well, did you all go to the baggage room then?

A. No, we didn't all go to the baggage room. We went up to the station.

Q. Tell us what happened there in that station.

A. We met a while up the station. My wife went over to inquire just all the particulars about that transportation of the dog down to Los Angeles, you see. I was away at the time. I think I was down at the rest room. She went on ahead to inquire.

Q. What conversation did you and she have about her [34] going over and finding out about it?

A. I told her I was going down to the rest room and I did not give her the dog. I took her to the next room with me and she went over.

Q. Well, did you ask her to find out?

A. Well, I told her to find out the particulars of what I have to do with this dog before I give him over.

Q. You went over to the rest room?

A. Yes.

Q. And she went to find out the particulars?

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A. Yes, the particulars.

Q. What happened then?

A. So I came back with the dog and when I came back, I waited for her to tell me particulars. A man calls me over. I see him calling (indicating).

Q. Was the man by your wife then?

A. Yes, the man must—yes, he was with my wife there.

Q. Where was your wife?

A. She was over at the baggage counter.

Q. By the place where this man was?

A. Yes.

Q. Where were you when he motioned to you?

A. I was quite a distance, just a way—at the far end of the counter.

Q. About how far?

A. Oh, I suppose it must have been 15, 20 feet away. [35]

Q. Did you have the crate at that time?

A. Yes.

Q. Had you been carrying the crate all the time?

A. Yes, I had the crate in my hand and the dog on the leash.

Q. All right. Just what happened then?

A. Well, he called me over and he says, "This your dog?" I says, "Yes."

You know, he was quite abrupt. He seemed to be all in a hurry and all confused. I said, "He is a very valuable dog. He is a trick dog. Remember

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that. He is a trick dog. He is a very valuable dog."

He says, "Well, all right. We will be careful with him anyhow."

I says, "No matter what you do with him, be careful with him because that is a very valuable animal. I brought him all the way from Ireland and I am going to see him safe. Be careful with him."

He says, "Come on. Put him up." I put the dog in the crate and I handed it up to him. I says, "Is that all right?" He says, "That is all right."

I said, "Where is the crate going? Where is he going now?" I said, "I want to watch this dog. Very valuable dog. Trick dog. Very valuable. That dog is worth more," says I, "than—well, he is—money just couldn't buy him. Be careful. I want to see him right to the end." [36]

He said, "You will see him where he is going now." He says, "There is a man coming in here to take him and he is going to bring him right there on the truck to put him in the baggage car."

I says, "Will that be long?"

He says, "No. The train is going right out." He says, "Only a few minutes here."

I says, "What is the rush? What is all the rush? After all, that is a valuable dog. Remember that, man. And I want to see that dog. Very valuable. That is a trick dog. Be careful when you are handling him."

He says, "Well, all right. You will see him."

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I says, "Will I be able to get in to see him? I want to accompany this dog on the train all the way down to Los Angeles. Can I do that? I want to know who is in charge to look after the dog while he is on that train and I want to be there. I want to be there to look after that dog and to give him any attention that he wants, such as fresh air or a little water or a little something or ventilation and maybe a little walk, if the train stops. If I get that opportunity, I want to know all that. Can I do that?"

He says, "Yes, you will be able to do that."

I says, "Will there be a man in charge?"

He says, "There will be a man in charge with the train and looking after him." [37]

I says, "Will I be able to get in to see him?"

He says, "Yes, you will."

I says, "Be careful with him, anyhow. He is a valuable dog. Watch him because I am going to travel with him if I can get in with him."

So the dog was brought around and I watched. He left this place, the counter here, and I walked over and he gave me the directions what way the truck would come and I was watching for the truck. The truck came up to the platform. There was a man wheeling it on—the baggage was all stacked up on it, and I looks and I see the crate that the dog was in turned upside down, you see. I rushed over and I said, "Here, just a minute. Stop that truck. There is a valuable dog in this truck case. That is a trick dog. He is upside down. Stop that.

(Deposition of Bernard Mitchell.)

If you can't take this little time to straighten it, I am going to remember that. That is a valuable dog in that case. That is a trick dog. He is going to Hollywood and is going to make pictures, that dog."

He says, "That is your trick dog?"

I said, "Here is the record with him there. Here is the record with him. I am going to prove it," says I. I says, "So fix him up. So fix the dog up." And I walks up beside it and holds the crate up. I said, "That is the way, you know." I followed him right up to the baggage car with the dog. I watched all the luggage going in and when [38] it was coming to my turn with the crate, I lifted the crate. I said, "Wait a minute before you put that dog in there. Can I get in with that dog?"

He says, "Oh, yes. You can get in."

I says, "Will there be a man in charge of this baggage car and start looking after this dog?"

He says, "Oh, yes, there will be a man in charge and he will look after it and do everything for it."

I says, "Will I be able to get in again? Can I get in with him and look after my dog, too? I want to travel with it. I am going to go. I am going to stay with my dog in the baggage car. That is a valuable dog. That is a trick dog. That is Pudsy, the wonder dog of Europe. I brought him all the way from Ireland. I am going to deliver him safe to Los Angeles. He has traveled from New York," says I, "and never turned a hair from him, from New York to Chicago."

(Deposition of Bernard Mitchell.)

I says, "I want him fresh as a daisy. I want to bring him to Los Angeles the same way."

He says, "Oh, well, you will get in all right."

I said, "Are you sure now? Because I don't get in to see that dog, if I can't get to see that dog, he is not going. I am not going. There is nobody going if I don't get on there."

So he said, "That is all right. You will get in. And there will be a man to look after him."

I said, "Thanks a lot, man. Thanks very much. Thanks [39] a million. As long as I know everything is all right, that I can get in to see him and knowing the dog is all right, I am all right."

So I thanked the man again and said, "Maybe you might see him on television."

Q. When you left, where was the dog?

A. Where I left it in the baggage car.

Q. Inside the car and in the crate?

A. Yes, in the crate.

Q. Did you see where he went?

A. Yes, sitting on the inside on the crate. So I left that dog. After I left it, I come right up and got into me seat. My seat on the train was pretty near the baggage car. I was just pretty lucky. I was so elated I got so near the baggage car so I could get in the same as I done from New York to Chicago. I give nobody any trouble seeing that the dog was safe and everybody was happy and satisfied.

Q. I think you have told us the rest of the story in your answers to the interrogatories and so on

(Deposition of Bernard Mitchell.)

when you were in Chicago there. Did you get another check for the dog?

A. Well, there was a check. The man put a check on the crate.

Q. You saw him put a check on the crate?

A. Put a check on the crate. [40]

Q. That was when you put the dog in the crate?

A. Yes.

Q. Wait a minute. That was after you put the dog in the crate and put the crate up on the counter; is that right? A. Yes.

Q. Then he put the check on the crate?

A. Yes.

Q. Did you sign a valuation slip like that?

A. No, I signed nothing.

Q. Did you see anybody sign that?

A. No, I didn't see anybody sign it.

Q. Is that your wife's handwriting?

A. Well, that could be my wife's.

Q. Well, you know your wife's handwriting?

A. Well, it could be my wife's. It is not mine. Yes, it is pretty like my wife's handwriting.

Q. You didn't see her write that?

A. I did not.

Q. Did she tell you that she had written it?

A. No.

Q. Did she ever tell you she wrote it?

A. After all this had been done, my dog was dead.

Q. But I mean——

(Deposition of Bernard Mitchell.)

A. Not beforehand I didn't know anything about it.

Q. But since then has she told you that she wrote it? [41] A. Yes. Oh, yes.

Q. When did she write that, do you know?

A. Well, I don't know. She must have wrote it while I was away.

Q. Did you get a check, a portion of this check, at the time that he put the one portion on the crate?

A. I think I have a portion of the check, yes. I think I have a portion.

Q. You still have that?

A. Yes, I think so.

Q. Did you have any conversation at the baggage counter other than what you have told us about?

A. No, no other conversation. Mostly all of it was just about the dog.

Q. Did you have any conversation with your wife while you were at the baggage counter there?

A. No. A man was—I mean, the man was in a hurry and rushing us on. He said the train was going out in a few minutes and he hadn't all the time to wait here. He began talking like that and saying, "Come on," rushing us.

Q. Well, O.K. Let us stop here and then if I have some questions later, I will get back to it later, but we will see what we can do with Mrs. Mitchell.

A. That is all right. That is as far as I left the dog in the car. [42]

(Deposition of Bernard Mitchell.)

Q. We have the rest of that in the interrogatories.

/s/ BERNARD MITCHELL,
Witness.

Subscribed and sworn to before me this 20th day of September, 1954.

[Seal] /s/ GEORGE H. CHULA,
Notary Public in and for the County of Los Angeles, State of California. [43]

State of California,
County of Los Angeles—ss.

I, Edward A. Oreb, a Notary Public within and for the County of Los Angeles and State of California, do hereby certify:

That, prior to being examined, the witness named in the foregoing deposition, to wit, Bernard Mitchell, was by me duly sworn to testify the truth, the whole truth and nothing but the truth;

That said deposition was taken down by me in shorthand at the time and place therein named, and thereafter reduced to typewriting under my direction.

I further certify that it was stipulated by and between counsel that said deposition may be read, corrected and signed by the witness before any Notary Public.

I further certify that I am not interested in the event of the action.

Witness my hand and seal this 12th day of July, 1954.

[Seal] /s/ EDWARD A. OREB,
Notary Public in and for the County of Los Angeles, State of California.

[Endorsed]: Filed October 29, 1954. [44]

[Title of District Court and Cause.]

DEPOSITION OF MRS. BERNARD MITCHELL

a witness herein, taken on behalf of the defendants, at 2 p.m., Tuesday, June 29, 1954, at 422 West 6th Street, Los Angeles 14, California, before Edward A. Oreb, a Notary Public within and for the County of Los Angeles and State of California, pursuant to the stipulation annexed to the deposition of Bernard Mitchell.

Appearances of Counsel:

For Plaintiff:
MONROE & CHULA, By
GEORGE H. CHULA, ESQ.

For Defendants:
E. E. BENNETT, ESQ.,
EDWARD C. RENWICK, ESQ.,
MALCOLM DAVIS, ESQ.,
JACK W. CRUMLEY, ESQ.,
DONALD M. LADD, JR., ESQ., By
MALCOLM DAVIS, ESQ.

MRS. BERNARD MITCHELL

a witness herein, having been first duly sworn, deposed and testified as follows:

Direct Examination

By Mr. Davis:

Q. Now, I will take your deposition, Mrs. Mitchell. A. Yes.

Q. Would your testimony be pretty much the same as that of your husband up to the time that you got to New York? A. Yes, exactly.

Q. Can you think of any differences?

A. No. You want me to start it at the beginning and say it?

Q. No, please don't.

A. I am not going to. I am not going into as much detail.

Q. But you listened to your husband as he told us about it, didn't you? A. Yes.

Q. In general your story would be just the same as his until you got to New York, would it not?

A. Yes.

Q. Now, when you got on the train in New York, do you remember that there were any slips signed such as this [2*] valuation slip, that is, in New York?

A. I don't remember signing anything. One thing I can tell you, if I ever signed anything, it was twenty-five points for a dollar. I knew perfectly I wouldn't have done it. I don't remember saying——

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

(Deposition of Mrs. Bernard Mitchell.)

Q. Listen to my questions. I am speaking to you about New York; do you recall? A. Yes.

Q. You have seen this valuation of baggage, haven't you? A. Yes.

Q. I am showing you a photostat of it now. That was in Chicago. Did you see a similar slip in New York?

A. I absolutely don't know. I don't know. I can't tell you.

Q. Now, were you and your husband together when the dog was checked in New York?

A. We were. We were. You had the dog do tricks for the man.

Q. Wait a minute. You forget he is here (indicating).

Just answer us.

A. Yes, I am sorry.

Q. Were you and your husband together all the time when the dog was checked in New York?

A. Yes.

Q. Did either of you sign one of these slips at that [3] time, do you remember, or your husband? A. I can't remember.

Q. You can't remember. Do you remember getting a portion of a baggage check in New York?

A. I must have got tickets. We must have. I forget. They wouldn't have let us in without it.

Q. That is right. Can you remember it?

A. No.

Q. Well, when you got to Chicago, as I recall,

(Deposition of Mrs. Bernard Mitchell.)

your husband got the dog. Well, the dog was with you on the train, wasn't he?

A. Yes, he was with me. He was with me from the train down to the baggage counter, just like over here to here that dog was a distance away (indicating). I could see it, him and the dog.

Q. Was he in the baggage car? A. Yes.

Q. The dog was in the baggage car?

A. For a while. While we were on the train, they said, "This is your seat." And there was the baggage car there and the door was opened and I could see him.

Q. When you got to Chicago, was the dog in the baggage car? A. Yes.

Q. How did you get him from the baggage car?

A. Barney went in for me and Barney brought his crate and him outside, out by the door, and I come by this [4] other one with the cases.

Q. You brought the cases and he brought the crate and the dog? A. Yes.

Q. Then you got in a taxi and went over to the station in Chicago?

A. These railroad people had this taxi ordered. We had nothing to do with it. So when we came the length of that other station, Chicago station, Barney went down to the toilet and I went over to this—well, a big station we were in. I went over to this place, and there was a man and I said to him, "Mister——"

Q. What did you say?

A. I says, "Whereabouts do you get this train

(Deposition of Mrs. Bernard Mitchell.)

for Los Angeles, because my husband has a very valuable dog and wants to get tickets for it," I said, "to go to Los Angeles." I must have been talking slow, because he says, "Come on," to me, "come on. I have to put all these things on the train. He had a whole lot of attache cases and everything." He said, "Are you the owner of the dog?"

I said, "No, my husband is the owner." Barney came in and he says, "Has your husband the tickets?" He says, "Show me the tickets."

And I went and opened my purse for the tickets. I just gave it all to him. He takes what he wants out of it. He says, "Come on." He gave me a big thing about that [5] height (indicating). He says, "Write your husband's name and destination, where you are going. Where you are going to."

I wrote it down and gave it back to him.

Q. Is this the slip of paper there?

A. I don't know.

Q. Instead of a copy, you know, that this is a copy?

A. I don't know what the color was. I can't remember what this thing was like, but I remember seeing it. I gives it back. There were directions on it. He says, "Here, put 25 here." I put 25 down and gave it back to him, and the man never said what it was or what it wasn't.

Q. Now, did you read that slip?

A. I didn't have time to hardly write it, let alone read it, Mister.

(Deposition of Mrs. Bernard Mitchell.)

Q. Where did you write? What did you have it on?

A. I think I had it on a table or whatever it was. Kind of a counter. I don't know what it was.

Q. Was it just one single sheet of paper or was it on a pad?

A. I forget. I don't know. I couldn't tell you as to what it was on. I think it was a book or something.

Q. Well, I will show you this little slip of paper here; is that the slip that you wrote on?

A. It must have been, but I forget what color it was or what it was like. I don't remember nothing about it, [6] only that I wrote Barney's name on it and the man told me to write it.

Q. And that is your handwriting, is it, on that slip? A. Yes.

Q. And this figure "25" there, is that in your handwriting?

A. Yes, the man told me to put "25." I never even seen what it was or anything else.

Q. Did you ask him what it was for?

A. I never asked him, to tell you the truth. He was an awful man. He was a cheeky man.

Q. Did you read anything on it or any of the printing that was on there?

A. Never did. I signed it and gave it back to him and he gave it back to me. He says, "Put your husband's name and address," and I put it and wrote and gave it back to him. He gave it back

(Deposition of Mrs. Bernard Mitchell.)

to me and he says, "Put 25." And I put 25 and gave it back to him. That was all I done.

Mr. Davis: I would like to attach a photostat of this.

Mr. Chula: That would be satisfactory. You are referring to what I would assume purports to be the original and you say it is the original and I would assume it would be the original.

Mr. Davis: Yes, so I would rather not put this in the deposition.

Mr. Chula: All right. We will put a photostat on it [7] and that will be satisfactory.

Q. (By Mr. Davis): Where was Mr. Mitchell when you wrote these things on this valuation slip?

A. He was way over there, doing something with the dog.

Q. Doing what?

A. Doing something with his muzzle or whatever you call it. Doing something to Pudsy. He just come in from the train and he was over here, oh, by the big long wall.

Q. About how far away from you was he at that time?

A. Well, only taking a guess, I would say from here (indicating) way over to the middle of the road there.

Q. Oh, about 60 feet or so, would that be right?

A. As far as in length. I can't tell you how far it was.

Mr. Chula: Tell us the distance by using this room.

(Deposition of Mrs. Bernard Mitchell.)

The Witness: Oh, it was far more than this.

Mr. Chula: How much more, twice as much?

The Witness: I can't swear to it. I don't want to tell a lie. Well, it was about twice as much as this.

Mr. Davis: Well, that would be about 30 feet, I think.

Mr. Chula: Somewhere around that.

The Witness: I called him and I said, "Barney, I got the tickets." Do you remember that?

Q. (By Mr. Davis): You called for Barney?

A. I said, "I have got the tickets." And the man——

Q. When did you call to Barney? [8]

A. When the man called him for to get the dog, this man called him.

Q. When did you call for him?

A. I didn't call for him, for the man to call him. I said, "Barney, I got the tickets." And I talked to him about putting in the thing and the crate and then he had a talk with me. He said, "Nothing will happen to him while we are waiting at the side of this big place." He said the dog would come in this big thing. So the minute we seen him coming, I said, "Barney, there is the crate upside down," and he went over to them. Then after we got in the train, after a while, Barney went out to the man. He went out to the man who was selling tickets or whatever he was doing, the porter, you know, the man that goes up and down the train, that man. Barney asked him if he could get to see the dog.

(Deposition of Mrs. Bernard Mitchell.)

The man said to him, "The baggage car is locked. It won't be opened until we get to some place," and Barney had told him what the dog was worth and Barney comes up to me and he says to me, "This man won't let me into the baggage car."

Q. We got all that. So you never mind about that. That isn't necessary because you already told us all that in these other interrogatories.

A. All right.

Q. Now, have you told us the whole conversation that you had with this man at the baggage [9] counter?

A. Yes. I says to him, "Mister, whereabouts do you get the train for Los Angeles?" I says, "My husband has a very valuable dog and wants to get the particulars of it."

I said, "I want to know about every facilities."

He says, "Where do you come from?"

I said, "New York."

He says, "Have you got the tickets? Where is it? I have to have the tickets."

I said, "I think I have the tickets. I think I have them." I gave them to him. He asked me for to sign the ticket and I took the whole lot out of my purse and he took whatever he wanted. He wrote something and I don't know what he wanted. He told me how much money it would be, but I forget how much it was that I gave him to get Pudsy's ticket.

Q. Did you pay him the money?

A. I gave him the money.

(Deposition of Mrs. Bernard Mitchell.)

Q. When was it that you signed this slip?

A. After he got the tickets off me. He got this ticket.

Q. Was it before or after you paid him the money?

A. I think it was after I paid him the money that he asked me to sign this thing. I can't swear to it. I think it was after. He said, "Sign this, your husband's name on that."

And I signed it. He told me to put the address on it. [10] I did and gave it back to him and he gave it back to me and he said, "Here, put 25." And I wrote it down and gave it back to him. He was in an awful hurry.

Q. How long did you take, all the time, from the time you first started to talk to him until you left the counter?

A. It couldn't have been three minutes, Mister, where the man had no time to breathe. He annoyed me that much. I didn't know what I was doing.

Q. Did he punch your ticket?

A. Punch it? I don't know.

Q. With a BC on it?

A. I couldn't tell you.

Mr. Davis: I think that is all.

Mr. Chula: That is all.

/s/ BULA MITCHELL,
Witness. [11]

State of California,
County of Los Angeles—ss.

I, Edward A. Oreb, a Notary Public within and for the County of Los Angeles and State of California, do hereby certify:

That, prior to being examined, the witness named in the foregoing deposition, to wit, Mrs. Bernard Mitchell, was by me duly sworn to testify the truth, the whole truth and nothing but the truth;

That said deposition was taken down by me in shorthand at the time and place therein named, and thereafter reduced to typewriting under my direction.

I further certify that it was stipulated by and between counsel that said deposition may be read, corrected and signed by the witness before any Notary Public.

I further certify that I am not interested in the event of the action.

Witness my hand and seal this 12th day of July, 1954.

[Seal] /s/ EDWARD A. OREB,
Notary Public in and for the County of Los Angeles, State of California.

[Endorsed]: Filed October 29, 1954. [12]

[Title of District Court and Cause.]

REPORTER'S TRANSCRIPT OF PROCEEDINGS

December 12, 1955

Appearances:

For the Plaintiff:
GEORGE H. CHULA.

For the Defendant Union Pacific Railroad Company, a Corporation:
MALCOLM DAVIS.

* * *

The Court: Maybe it will help you if I tell you what I think is your stumbling block.

Mr. Chula: Surely.

The Court: I don't like these theories by which you can go out and file a tariff somewhere and keep it under a counter and yet submit the world to it.

If you go on an airplane flight between here and Europe, for instance, you could never get more than $9,000.00 damages for loss of life, because of an international convention that sets that up, no matter how highly you might evaluate your life and inform the airplane company of it. Those things are generally, to my personal conscience, vicious. But there are places where they have legal validity.

Now, in your case, Mr. Mitchell was called upon to value the dog upon a declaration, which was the declaration that was provided, as part of the regular routine of checking baggage by the carrier. If the

dog was valued at $25.00 or less, he got carried, as I understand the record here, as incidental passage of other things, namely, Mr. Mitchell, although I have never been able to figure the $8.33, what that paid. But Mr. Mitchell valued the dog at $25.00.

Now, if he had valued the dog at what he says it was [5*] worth in his complaint, he would have had to pay an additional sum for passage. Is he entitled to more than the value he placed on it in his declaration? Is he not estopped by the value he asserted in the document given to the railroad company?

Mr. Chula: I would say this, your Honor: First, our contention is he is not estopped, and I say—when the question of estoppel comes up, I was going to seek to point out to the court that I believe the railroad company is estopped from claiming the valuation of $25.00 for these reasons.

Now, if we can just go over the facts at the counter. Mrs. Mitchell goes up to the counter and asks about shipping the dog and tells the man it is a very valuable dog, and so on. We have the information in the deposition, as to what took place at the counter.

The man at the counter advises her, let us assume—let us assume she knew what she was doing when she wrote "25" down there. She knew it was $25.00 and she was valuing it at $25.00.

Now, the question of the placing of the sum of "25," say it was done, and assuming it was done, $25.00 on the valuation slip is not a statement that

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

this is the value, but that this is the limitation of liability that you will take. Assume it was so.

Now, Mrs. Mitchell, if she did write down and did intend [6] it to be $25.00, did so after being advised—she was willing to accept—this is on assumed facts, contrary to the true facts, but assuming them to be so, she did so limit her liability to $25.00 after being advised by the baggageman that Mr. Mitchell, or that the parties would be able to go into the baggage car at all times to care for the dog, to feed it, to water it, to otherwise care for it, and that there would be someone in attendance in the baggage car to look after the dog.

Now, your Honor, the baggage notation I do not believe is a statement of value. I say it is a limitation of what you are going to be able to claim.

If you or I were in that circumstance with Mr. Mitchell and should determine, "All right. They are going to let me get into the baggage car any time I want to feed and water my dog. The man told me so. That is what I can do. He said, 'There will be more attendants. We have carried more valuable things than these.' " And you and I were sitting on this side of the counter (indicating) and we are from Ireland and we just came over in this big world—we are looking all over it, it is a big thing, and get in that station—The first time I got in the Service I thought I was lost in the station at Chicago.

In all fairness, we are sitting on this side of the counter and we say that under those circumstances, assuming [7] it to be so, taking the worst, we say,

"All right. If I can go in and see my dog, I can water him, I can feed him, I am not worried about my dog. If he dies it is my fault."

So I will say, "I will limit your liability to $25.00," and I write down "25"——

Your Honor raised the point, is Mr. Mitchell estopped because his agent, if it can be construed as agent—I think under our laws here I think it would be, and I think probably counsel is strong on that point—Mrs. Mitchell writes the $25.00 down, can he be estopped to later claim a greater amount?

If we are going to use these rules of estoppel and things like that, surely, your Honor, estoppel would apply to the railroad company, because we wouldn't. It is a question of fact for determination.

They told the man it was a valuable dog and they came over here for the express purpose of exhibiting this animal, and to say it was worth $25.00 is flying in the face of reason. They had spent hundreds of dollars getting over here for this purpose.

Now, if we hadn't been able to get in this baggage car, we wouldn't have traveled on the train at all, if we had known it was somebody else taking care of the animal.

Surely, a fair opportunity would have been presented to the party putting down the "25," that they are making a [8] choice here, that they are taking a certain amount of risk, and, therefore, they wouldn't have limited the liability to twenty-five.

I think that the railroad company is estopped,

also, so far as the ticket is concerned, because of that reason.

In other words, the $25.00 is not a statement of value. It is a statement of limitation of liability.

Can it be said that we would have limited liability if we had not been misled—I say "Misled"—or defrauded, or however the statement may be; misinformed by the agent for the railroad company?

Thereby, I think the question of whether the "25" was put down there is sort of canceled out on both sides. There is an estoppel both ways.

If we are going to use—but, as to the railroad company, they would be estopped to claim this $25.00 limitation. For instance, I think—for example, your Honor, if we were going to ship something valuable and we were told it was going to be in a certain type of car that would have air, and we didn't know the facts, and we don't know the fact; we are sitting on this side of the counter (indicating), and the man says, "Sir, the animal is going to have a lot of air," and they put him in something that is sealed tight, so it is just a matter of time that the heat and the exhaustion will cause the animal to die, can it be said the person who [9] chose to limit the liability to $25.00 had a fair and ample opportunity to choose the limitation of liability? I think not.

Now, if Mr. Mitchell, assuming the $25.00 was put there as a limitation—I will argue strongly on it, I feel strongly on it—couldn't even limit it, it was intended as a limitation, assuming everything they say is so, is true, the situation would have been

different if, after the animal got on the car, there had been someone in the baggage car to care for it. There wasn't. We had been advised there would be.

If in that situation—I can see limited liability—he got on the car, were able to get in the car and feed the dog and water the dog, all those things would have been cared for and we would have known what we were limiting our liability for, and we would have accepted that risk.

But in this case, your Honor, we were not admitted into the baggage car. We attempted at all times, as the deposition shows and as the complaint shows, to get in to see the dog; begged and pleaded all the way up and down the train, to get in to take care of this dog.

The Court: If you had set forth its true value, I should think they would have let you in.

Mr. Chula: That is what I am assuming. Just like maybe in certain other fields people just do a certain job and they [10] do a certain job. These people are from Ireland. They might look like they are funny little people. They might think they are cracked in the head, being from Ireland and talking——

The Court: I wish you had cleaned up his language a little in his affidavit.

Mr. Chula: I attempted, as best I could, to use the words he used, that is all. I don't know if there is anything obnoxious to the court.

The Court: That is the unfortunate thing in drawing an affidavit. You can't get too much color

of Ireland in an affidavit by having an Irishman trying to cast it a legal language.

Mr. Chula: I felt, maybe wrongly or rightfully, sometimes attorneys take too much freedom when they draw them for clients to sign. What I did, I just took his statement and I had the secretary take off and use it the way he had it.

The Court: What was the $8.33 paid for? That certainly will not buy a ticket from Chicago to Los Angeles on the City of Los Angeles.

Mr. Chula: That $8.33, your Honor, in my understanding, is paid for the transportation of the dog. Now, the only thing, under the Rules and Regulations—the only thing we have under consideration, attached to the original motion [11] under Rule 6(c), all these things we ask for—this question of the ticket, maybe I ought to stick on that.

The only necessity of presenting a passenger ticket, apparently, is not to get any free baggage for this dog, because, I don't know, possibly if I went there without a ticket they might not let me on the train, I don't know. I could probably ship the dog otherwise.

But we paid for the transportation of the dog; it wasn't free. And the only reason, I think, it would be necessary to show a ticket that we are going to, you know, indicate that somebody is going to be able to take that dog off the train.

In addition to that, it says, under Rule 6(c), that they must be "accompanied by owners or caretakers, who present valid transportation and who

will provide proper facilities for loading and unloading, feeding and watering."

We tried to. We were there and they refused us the opportunity of feeding and watering and caring for our dog.

Assuming we agreed to a limitation of $25.00, if they would let us do these things. They refused. How can they refuse us the right to care for our dog and still limit us to our liability? I think they have been estopped.

If they had done their duty, then the limitation of liability, assuming it were so, might be fair—given a fair and ample opportunity. [12]

The Court: Are the depositions formally in the record on this motion?

Mr. Davis: They should be. I think if we can dispose of the matter now, we should if we can.

The Court: Is it understood the depositions are formally in the record?

Mr. Chula: Yes.

Mr. Davis: So stipulated, your Honor.

Mr. Chula: And speaking of the question—I understood—we have been arguing back and forth this way—that was my understanding. I spoke with counsel. We have no objection to it and both want it that way, so far as the depositions being part of the record.

Now, I trust, your Honor, that—I think I have made my motion relatively clear on that point there.

The Court: I think I have your point.

Now, another point is this: I think, in view of

the Nothnagle case, which is a case with certain similarities, but not exactly similar, that it shows the basic trend and thought in a case of this type, and that is there must be fair and ample opportunity to choose.

Now, here we have, taking the facts as they were, so far as the plaintiff's complaint shows, and so on, Mrs. Mitchell was asked by this baggage clerk to sign the name of the owner and the address; and she did on this slip. [13]

These people are English-speaking people, that is true, but I assume that the customs, ideas and manner of living and thought and checking is a little bit different over in Ireland than here. Honesty is a characteristic of both countries, at least in its idealistic contemplation of the things it does and the requirements upon people.

Mr. Chula: That is correct, your Honor. As we go a little further among these very strong Catholic people in Ireland, truth is actually a very strong point with them, too.

So we can sort of gather from the deposition that the facts are as stated, even more so than under oath.

If you will note, your Honor, the valuation slip, it has twenty-five in numbers with quote marks on either side of it; twenty-five with little quote marks on either side of it.

I don't know whether the deposition shows it or not, but I believe it does—I can't recall exactly now—Mrs. Mitchell at that time didn't even know what the dollar sign would mean. She said she

didn't know whether it was stones or what it would be. "I don't know what it would be—" some saying they have over there. She was asked by the man.

Could it be said she had a fair and full opportunity to choose between a higher and lower rate? I think it is a question of fact and not a question of law. [14]

In this particular case it is a little unusual in that regard, that she goes up and shows the man her ticket.

He says, "Fine," and charges a certain amount of money for the dog, and then he hands her the slip and says, you know, "Put down the name of the owner."

On his affidavit he says Mr. Mitchell did this. Whether he was testifying from his own recollection or not, I don't know, when he made the affidavit. But, apparently, he was mistaken in that regard, because Mr. Mitchell did not fill out the valuation slip.

He asked her, "Write 'Mitchell, Garden Grove, California,' " and hands it back to the man.

She told the man already, "It is a valuable dog." He is put on some sort of notice to give her ample opportunity to value the dog higher.

In addition to this other field we are talking about, being able to feed the dog and water it, he hands it back and he says to put down "$25.00," and she writes "25" and puts it in quote marks.

Does that look like the actions of a person who is putting down "$25.00" as the valuation? This may be a slim or small question of fact, but it does

resolve itself down to a question of fact as to whether Mrs. Mitchell was given a fair and ample opportunity to choose. Our pleadings indicate she was not. And whether she did or did not have [15] a fair and ample opportunity would be a question of fact. It might be—supposed to be a question of law.

Under our general thinking, if something is down, it is down in tariff acts and so on, and maybe not clearly a question of fact. Just look and say, "Boom," and it is a question of fact (indicating).

In the particular situation, and the information we have in our deposition, in our affidavit in opposition to this motion, it indicates there is some question of fact here. It may not be as easily discernible as in some other cases, but it gets to a point it is a question of fact.

The Court: The question of fact in the case is, was there negligence? That question is resolved by the defendants confessing negligence.

The question of fact might be there as to the value of the dog. Mr. Davis has put in a lot of comment, to which he draws from as his comment upon the deposition.

The fact that this was a pickup dog and not a pedigreed animal, that nothing was paid for it, that it was owner-trained, and so on, it has no value. The court can't go for that.

I think, if we had the actual problem of valuation of the dog, as to its real value, those would be factors to be considered, but they wouldn't be controlling. They wouldn't fix the value of the dog

as under $25.00, as a matter of law. [16] And I can see plenty of things suggested here which, if they came into evidence, the dog might have a substantially greater value.

But when the owner goes to a baggage room and fills in a declaration, placing the value at $25.00, this court holds they cannot thereafter collect a greater sum.

So the motion for summary judgment is granted.

I don't know that the findings are quite what the court would want to sign, but I will work on them myself.

[Endorsed]: Filed February 27, 1956. [17]

[Title of District Court and Cause.]

CERTIFICATE BY CLERK

I, John A. Childress, Clerk of the United States District Court for the Southern District of California, do hereby certify that the foregoing pages numbered 1 to 109, inclusive, contain the original

Complaint;

Answer of Chicago & North Western Railway Co.;

Motion & Notice of Motion for Summary Judgment together with Statement of Reasons & Memorandum of Points & Authorities in Support Thereof;

Affidavit of Bernard Mitchell in Opposition to Motion for Summary Judgment;

Findings of Fact & Conclusions of Law;

Summary Judgment;

Notice of Appeal;

Appellee's Designation of Matters to Be Included in Record on Appeal;

Motion for Extension of Time Within Which to File Record on Appeal;

Designation of Additional Portions of Record on Appeal by Appellant After Designation by Appellees;

Supplemental Memorandum in Support of Motion for Summary Judgment;

which, together with Deposition of Bernard Mitchell, taken at Los Angeles, California, on June 29, 1954; and 1 volume of Reporter's Transcript of Proceedings on Monday, December 12, 1955, in the above-entitled cause, constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in said cause.

I further certify that an examination of the docket and files has been made and I cannot find where Interrogatories Propounded to Plaintiff and the Answers Thereto has been filed, as designated by the appellees in this case.

I further certify that my fees for preparing the foregoing record amount to $2.00, which sum has been paid by appellant.

Witness my hand and the seal of said District Court, this 28th day of February, 1956.

[Seal] JOHN A. CHILDRESS,
Clerk;

By /s/ CHARLES E. JONES,
Deputy.

[Endorsed]: No. 15068. United States Court of Appeals for the Ninth Circuit. Bernard Mitchell, Appellant, vs. Union Pacific Railroad Co., a Corporation; Chicago Northwestern Railroad Co., a Corporation, Appellees. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed March 11, 1956.

Docketed March 15, 1956.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

No. 15068.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BERNARD MITCHELL,

Appellant,

vs.

UNION PACIFIC RAILROAD CO., a corporation; CHICAGO NORTHWESTERN RAILROAD CO., a corporation,

Appellees.

APPELLEES' BRIEF.

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IN THE

United States Court of Appeals

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BERNARD MITCHELL,

Appellant,

vs.

UNION PACIFIC RAILROAD CO., a corporation; CHICAGO NORTHWESTERN RAILROAD CO., a corporation,

Appellees.

APPELLEES' BRIEF.

Statement.

The statement of facts set forth in Appellant's Opening Brief is generally correct. It should be added, however, that at the time Mrs. Bula Mitchell had the transaction regarding the checking of the dog with the baggage clerk, Mr. Mitchell, was near by, being about 15 to 20 feet away [Tr. p. 79]. Also, according to Mrs. Mitchell [Tr. pp. 91-92], her husband came in as she was just beginning her conversation with the clerk. After Barney came in, the clerk asked her to show him the tickets and Mrs. Mitchell opened her purse and let him take what he wished [Tr. p. 91]. The clerk then gave Mrs. Mitchell the valuation slip and said, "Write your husband's name and destination, where you are going." [Tr. p. 91.] She wrote this on the slip and gave it back to him and then again he returned it to her to fill in the amount of valuation [Tr. p. 91]. It is shown beyond dispute that Mrs. Mitchell had the slip completely in her own possession on at least two occasions, with opportunity to read it.

ARGUMENT.

I.

There Was No Genuine Issue as to Any Material Fact.

In Point I of his argument, Appellant refers to certain alleged contradictions between the affidavits filed in support of the Motion for Summary Judgment and the interrogatories and affidavit submitted by the Appellant and also the depositions of Appellant and his wife. There are some discrepancies in this respect. The affidavit of E. R. Foster is to the effect that he saw *Mr.* Mitchell make out the valuation slip in his own handwriting. His recollection was apparently faulty and apparently it was really Mrs. Mitchell who performed this act in the presence of her husband. It is submitted that as a matter of law there is no difference between these two sets of facts and that Mr. Mitchell is just as much bound by the actions of Mrs. Mitchell, performed in his presence and later ratified by him when he handed over the dog for placing on the train, as if he had done the same acts himself. It is true that Mitchell says he did not know exactly what Mrs. Mitchell was doing, but he certainly had every opportunity to find out and is, therefore, in law, bound by her actions just as much as if he knew all about them. In other words, the version of the facts contended for by plaintiff, together with all permissible inferences, is insufficient to raise any actual issues, but on the contrary demands a summary decision against him. The judgment allows for resolution of all factual differences in plaintiff's favor, so that no *genuine issue* of fact remains.

Appellant also refers to much lengthy conversation in which Mr. Mitchell is alleged to have stated to various employees of the Appellee, Chicago and Northwestern Railway Company, that the dog was very valuable, that he

desired to be allowed to look after the dog during the passage and that the employees in question promised that Appellant would be able to do so. This has not been contradicted in any way by the Appellees and, therefore, there is no issue as to these facts.

Appellant refers to the testimony of Mrs. Mitchell with regard to her writing in the number "25" in the valuation slip as constituting an issue of fact. No such issue really exists. She admits actually writing the words and figures in her own handwriting and there is, therefore, no issue of fact as to her doing so [Tr. p. 91]. Appellant argues that her testimony that she did not read the printed portion of the slip and did not understand the significance of her writing the figure "25", makes an issue of fact. This is not an issue of fact, but is merely a question as to what legal significance must be attached to her admitted actions, as a matter of law.

Appellant claims that he was not given an "intelligent choice" as to whether he desired to declare and pay for a higher valuation on the dog. The facts themselves are not in dispute. It is merely a question as to whether the facts, undisputed as they are, fasten knowledge upon the Appellant as a matter of law.

At the conclusion of Point I, Appellant makes an argument which is naive indeed. He says that the defendant misled Mr. Mitchell into believing that his dog would be cared for in the baggage car and that plaintiff would have access to the dog at all times. Appellant says that if this had been true, Mr. Mitchell would have been justified in relying on the $25.00 valuation and not paying any extra-charge therefor, but that if Mr. Mitchell had known the truth and had known that the dog was going to be neglected, then he would have declared and paid for a higher

valuation so as to protect himself in the event something should happen to the dog. In other words, if there wasn't much risk of injury to the dog, Mr. Mitchell was not going to pay anything extra on the theory that the dog was valuable. But, if there was going to be any risk of injury to the dog, then he thinks he should have had the right to declare a higher valuation and get more money. The element of risk may have been an actual factor in Mr. Mitchell's determination of these questions, but it would not seem to have any legitimate bearing on the actual value of the dog.

II.

The Doctrine of Estoppel Is Not Applicable Under the Tariff Provisions.

The doctrine of estoppel cannot properly be invoked to defeat the application of the provisions of a tariff such as the one involved in this case. It is a matter of paramount public policy that after the establishment of tariff provisions both carrier and passenger must be bound thereby. One purpose of establishing tariffs was to eliminate the practice of "rebating". Another was to insure similar treatment for everyone. If under particular circumstances a carrier were to be estopped from setting up the tariff provisions, it is easily seen how those provisions might be circumvented by collusion between the carrier and any particular patron. There are many cases expressing the above general thoughts. However, since this is a case involving the carriage of baggage on a passenger train, it is felt that the case of *Boston & M. R. Co. v. Hooker,* 233 U. S. 97, 58 L. Ed. 868, completely governs the situation. In that case the tariff in question read:

> "For excess value the rate will be one-half of the current excess baggage rate per one hundred pounds

for each $100.00, or fraction thereof, of increased value declared. The minimum charge for excess value will be 15¢

"Baggage liability is limited to personal baggage not to exceed $100.00 in value for a passenger presenting a full ticket and $50.00 in value for a half ticket, unless a greater value is declared and stipulated by the owner and excess charges thereon paid at time of checking the baggage."

This tariff provision is similar in all material respects to the tariff provisions set forth in the Transcript on pages 23 to 31, inclusive.

In the *Hooker* case, the plaintiff passenger was not given any information with respect to her ability to obtain greater protection by paying a higher rate, although her luggage was obviously worth much more than the $100.00 limitation. Mr. Samuel Williston, representing the plaintiff, argued that the tariff provision was in reality an attempt by the carrier to escape liability for its own negligence, contrary to common law and statute. He also contended that since the passenger had no actual knowledge of her ability to obtain greater protection by paying a higher rate, the mere fact that such rates were published in the tariff should not cause them to be binding upon her. After an unusually full consideration of these questions, the court rejected both contentions. In the first place, the court held that the tariff provision was a statement of "rates, fares and charges" required to be published by Section 6 of the Interstate Commerce Act, saying:

"We are, therefore, of the opinion that the requirement published concerning the amount of the liability of the defendant, based upon additional payment where baggage was declared to exceed $100.00 in value, was determinative of the rate to be charged,

and did affect the service to be rendered to the passenger, as it fixed the price to be paid for the service rendered in the particular case, and was, therefore, a regulation within the meaning of the statute."

This of course is a direct and complete answer to the Appellant's contention that misrepresentation by Appellees' agent estops Appellees from claiming the benefit of the tariff. In the *Hooker* case, the passenger had no knowledge of any limitation on the carrier's liability and had no knowledge of her ability to obtain greater protection by paying a higher rate. This is the same claim as is made by the Appellant here when he says that Mrs. Mitchell did not know what she was doing when she signed the valuation slip and that the effect of what she was doing was not explained to her and was also not explained to Mr. Mitchell. It applies also to the Appellant's contention that when he himself told Appellees' agents how valuable the dog was, they did not tell him how he could get greater protection.

With respect to the absolute nature of the tariff provisions and the public policy involved in not allowing passenger or carrier to deviate from them, the court said in the *Hooker* case (quoting from *Kansas City Southern R. Co. v. Carl,* 227 U. S. 652, 57 L. Ed. 688):

> " 'The valuation the shipper declares determines the legal rate where there are two rates based upon valuation. He must take notice of the rate applicable, and actual want of knowledge is no excuse. The rate, when made out and filed, is notice, and its effect is not lost, although it is not actually posted in the station. Texas & P. R. Co. v. Mugg, 202 U. S. 242, 50 L. ed. 1011, 26 Sup. Ct. Rep. 628; Chicago & A. R. Co. v. Kirby, 225 U. S. 155, 56 L. ed. 1033, 32 Sup. Ct. Rep. 648. It would open a wide door to

fraud and destroy the uniform operation of the published tariff rate sheets. When there are two published rates, based upon difference in value, the legal rate automatically attaches itself to the declared or agreed value. Neither the intentional nor accidental misstatement of the applicable published rate, will bind the carrier or shipper. The lawful rate is that which the carrier must exact and that which the shipper must pay. . . . To the extent that such limitations of liability are not forbidden by law, they become, when filed, a part of the rate.' "

The *Hooker* case involved a transaction which occurred before the Cummins Amendment to the Interstate Commerce Act in 1915 and the subsequent amendment to the Cummins Amendment in 1916. However, no substantial change so far as baggage is concerned was brought about by that subsequent legislation. This was specifically decided in *Galveston H. & S. A. R. Co. v. Woodbury,* 254 U. S. 357, 65 L. Ed. 301. Mr. Justice Brandeis, speaking for a unanimous court, said:

". . . The subsequent legislation, the Cummins Amendment, Act of March 4, 1915, chap. 176, 38 Stat. at L. 1196, as amended by the Act of August 9, 1916, chap. 301, 39 Stat. at L. 441, Comp. Stat. Sec. 8592, Fed. Stat. Anno. Supp. 1918, p. 387, has not altered the rule regarding liability for baggage."

Also,

"Since the transportation here in question was subject to the Act to Regulate Commerce, both carrier and passenger were bound by the provisions of the published tariffs. As these limited the recovery for baggage carried to $100, in the absence of a declaration of higher value and the payment of an excess charge, and as no such declaration was made and excess charge paid, that sum only was recoverable."

Some of the later cases involving similar questions are:

Wilkes v. Braniff Airways, 288 P. 2d 377 (Okla., Oct. 4, 1955).

In this case the plaintiff checked her baggage at Oklahoma City for carriage to Memphis. It disappeared en route. Bag and contents were conceded to be worth $918.50. Plaintiff sued for that amount, and defendant defended on the basis of its tariff limiting liability to $100.00 in absence of a declaration of higher value and payment of an additional charge therefore at the time of checking the baggage. Plaintiff admits that she did not pay any such additional charge but says she declared a higher value because she told the defendant's agent when she checked her bag, "I have $800 or $900 worth of clothes in my bags. Be careful with my luggage." She also claimed that she had no actual knowledge of the tariff provisions. The trial court directed a verdict for defendant. *Affirmed.* The court held that the rules for air travel are the same as those governing rail travel; that both carrier and passenger are bound by the tariff provisions which passengers are conclusively presumed to know, and that the carrier is forbidden to deviate from them so as to discriminate in favor of any particular passenger.

The plaintiff also pleaded that the defendant was estopped to plead this limitation of liability in view of the plaintiff's statement of the value of her bag and the defendant's agent's failure thereupon to tell her of the limitation. This contention was referred to but flatly rejected.

See, also:

Hartzberg v. N. Y. C. R. Co., 41 N. Y. S. 2d 345 (1943);

Beaumont v. P. R. Co., 131 N. Y. S. 2d 652, aff'd 127 N. E. 2d 80;

Treadway v. Terminal Railroad Association of St. Louis, 84 S. W. 2d 143 (1935);

Cray v. Pa. Greyhound, 110 A. 2d 892 (Pa. Sup. 1955);

Campbell v. Tri-State Transit Co., 17 So. 2d 327 (1944).

In Point III of his brief, Appellant says the tariff provision should not apply as against a charge that Appellees' agent misled Appellant with respect to how the dog would be cared for on the train and as to its accessibility to the Appellant while on the train. He refers to this as a species of fraud. Also, Appellant complains that since the third cause of action sets forth wilful misconduct or wilful negligence, the tariff provisions again should not be applicable. The answer to these contentions is the paramount public policy in seeing to it that both passenger and carrier abide by the provisions of the published tariffs. Appellant's arguments would have some validity if the question were the avoidance of liability by the carrier, but they have no application to our case, where the question is merely limitation on the *amount* of liability, based on a choice of rates.

As to Appellant's claim that he was given assurance of special treatment for the dog, it should be noted that the Interstate Commerce Act (49 U. S. C. A., Sec. 6(7)), provides:

> "No carrier shall * * * extend to any shipper or person any privileges or facilities in the transportation of persons or property, except such as are specified in such tariffs."

In our case, the Appellant, in his affidavits and in his deposition, keeps reiterating the fact that he told the baggage agent and all other employees of the railroad with whom he came in contact, that "Pudsy" was a trick dog, was the "Wonder Dog of Europe," etc., and also makes much of his inquiries as to whether he would be allowed to attend to "Pudsy" while "Pudsy" was in the baggage car, promises that some railroad employee would be in the baggage car at all times, etc., etc. The tariff provisions do not contain any special provisions for taking care of dogs and make no statement as to an attendant being in the car at all times, and, therefore, the making of any special contract for any such purpose would be forbidden by the Interstate Commerce Act. One of many cases illustrating the point is *C. & A. v. Kirby,* 225 U. S. 155, 56 L. Ed. 1033.

In that case the carrier contracted specially and specifically to transport a car of high grade horses to a junction point in time to be put into a fast train for New York. The carrier failed to make the connection and thereby, due to damage to the horses and failure to get to New York at a certain time, the plaintiff lost several thousand dollars. The fact that this was likely to happen was thoroughly known to the carrier and, therefore, if there could be any special undertaking to be liable for the damage, the carrier would certainly have been bound to respond to the plaintiff. However, the court reversed the lower court judgment for the plaintiff, calling attention to the fact that the tariff provisions did not provide for any expedited service, nor for transportation by any particular train and that a carrier cannot validly make a special contact for a service not published in the tariff and not available to everyone.

III.

The Valuation Slip Constitutes a Bar to Appellant's Recovery as a Matter of Law.

Appellees believe that the tariff provisions govern this case. However, the trial judge disregarded the tariff, and based his decision wholly on the value declaration. Considering the facts in the light most favorable to Appellant's contentions, the only possible conclusion from those facts is that Appellant is estopped to deny the contractual limitation of the value of "Pudsy" to $25.00.

According to Appellant himself, he went to the rest room, carrying the dog's crate and leading the dog, while Mrs. Mitchell went to "get the particulars" as to checking "Pudsy" on the train [Tr. pp. 78, 79]. When he came back to the baggage counter his wife was with the baggage clerk, and Appellant was at the counter about 15 or 20 feet away [Tr. p. 79]. The clerk asked Appellant to hand over the dog. Without asking any questions about the details of the transaction, either of the clerk or his wife, Appellant put the dog in the crate and handed it over [Tr. p. 80].

According to Mrs. Mitchell, she went and talked to the clerk while Appellant went to the rest room [Tr. p. 90]. Close to the beginning of the conversation, "Barney came in * * *" [Tr. p. 91]. After that, at the clerk's request, she let the clerk have their tickets, paid him some money [Tr. pp. 95, 96], and then made out the valuation slip—all this with Barney standing by.

Mrs. Mitchell says she did not read the valuation slip, and Appellant relies on this as constituting an issue of fact. As to this the cases hold, however, that as a matter of law she must be deemed to have read it.

Thus, in 12 Cal. Jur. 2d 262, Contracts, Section 61, it is said:

> "When a party, negligent in not informing himself of the contents of a written contract, signs or accepts the agreement with full opportunity of knowing the true facts, he cannot, in the absence of fraud or misrepresentation, avoid liability on the ground that he was mistaken concerning the terms. He cannot be heard to say that he did not read the contract and does not know its contents. He has a legal duty to read a contract before executing it. The fact that he is illiterate does not change the rule. The care of a prudent man in the transaction of his business demands an examination of an instrument before signing, either by himself or by someone for him in whom he has a right to place confidence. If, then, a person enters into an obligation free from fraud, free from undue influence, and without the existence of relations of confidence and trust, the courts will not relieve him from the effects of executing the instrument without reading it or having it read to him."

Also, in *N. Y. C. & H. R. R. Co. v. Beaham,* 242 U. S. 148, 61 L. Ed. 210, the court said:

> "In the circumstances disclosed, acceptance and use of the ticket sufficed to establish an agreement *prima facie* valid which limited the carrier's liability. Mere failure by the passenger to read matter plainly placed before her could not overcome the presumption of assent. New York C. & H. R. R. Co. v. Fraloff, 100 U. S. 24, 27, 25 L. ed. 531, 533; The Kensington, 183 U. S. 263, 46 L. ed. 190, 22 Sup. Ct. Rep. 102; Fonseca v. Cunard S. S. Co., 153 Mass. 553, 12 L. R. A. 340, 25 Am. St. Rep. 660, 27 N. E. 665." (P. 216.)

Mrs. Mitchell attributes her failure to read the valuation contract to the impatience of the clerk, but admits that she had it completely in her possession first when she wrote in Appellant's name and address, and again when the clerk asked her to fill in the amount. A mere glance on either occasion would have been enough to inform her. No fine print or ambiguous language is involved. On the contrary, it is a boldly printed statement that the baggage "is valued at not exceeding $..... and in case of loss or damage to such property, claim will not be made for a greater amount." And at the bottom appears, "Baggage of excess value will be charged for subject to tariff regulations." [Tr. p. 16.] Appellant himself was present during all significant parts of the transaction. Certainly since he was at the counter while his wife exhibited their tickets, paid the excess baggage fee, and signed the valuation slip, and since he made no protest, no effort to obtain information, and then put the dog in the crate and handed it over to the clerk, he cannot now be heard to say that he did not authorize Mrs. Mitchell to do anything but "get the particulars."

Recent cases in point are:

Normann v. Burnham's Van Service, 73 So. 2d 640;

Beaumont v. P. R. Co., 131 N. Y. S. 2d 652, aff'd 127 N. E. 2d 80, *supra.*

Furthermore, the Appellant's act in handing over the dog constituted a ratification, if any were needed.

In *Hutchinson Co v. Gould,* 180 Cal. 356, the plaintiff sought to foreclose a mechanic's lien against the defendant's property for the price of improvements made under a contract signed on defendant's behalf by one Austin, who theretofore had represented defendant and other owners in the tract in other matters. After Austin signed for defendant the plaintiff spoke to defendant, told him that Austin had signed the contract and the defendant said "OK." Now defendant attempts to say that Austin had no authority to sign the particular contract and that there was no ratification because the defendant didn't know the terms of the contract and cannot be held to a ratification without a showing that he knew what he was ratifying. This contention was held invalid and the court affirmed judgment for the plaintiff. The court said:

> ". . . It is true that the nature and character of the proposed improvements and the price therefor and the extent thereof—essential features of the contract—were not disclosed by the statement and question of Mr. Hutchinson. On the other hand, Mr. Gould knew of his ownership of the lots fronting upon the streets in question; knew Mr. Austin and his familiarity with the contract and with the conditions necessary for successful sales, and his question concerning the contract, 'Did Mr. Austin sign it?' showed that he was willing to trust to the judgment of Mr. Austin in regard to the matters not disclosed by Mr. Hutchinson's question. As is said in 2 Corpus Juris, 481: 'The lack of full knowledge does not protect a principal who is wilfully ignorant, and deliberately chooses to act without such knowledge, as where, knowing that he is ignorant of some of the facts, he has such confidence in his agent that he is

willing to assume the risk and ratify the act without making inquiry for further information than he at the time possesses, or where he intentionally and deliberately ratifies without full knowledge, under circumstances which are sufficient to put a reasonable man upon inquiry.' (See, also, to the same effect, Mechem on Agency, 2d ed., sec. 404; *Ballard v. Nye,* 138 Cal. 588, 598 (72 Pac. 156); *Pope v. Armsby,* 111 Cal. 159 (43 Pac. 589); *Phillips v. Phillips,* 163 Cal. 530, 535 (127 Pac. 346).)" (P. 358.)

See, also:

Schnier v. Percival, 83 Cal. App. 470.

2 Cal. Jur. 2d 747, Agency, Section 86, says:

"*Constructive Knowledge.* Constructive knowledge is ordinarily insufficient to support a ratification. However, the general rule that knowledge is essential to a binding ratification is intended to protect the vigilant, not to aid those who, advised by the situation and surroundings that an inquiry should be made, make none. Hence, if a principal, knowing that he is ignorant of some of the facts relating to an unauthorized act of his agent, deliberately ratifies that act, he assumes the risk and is bound to the same extent as if he had actual knowledge. Similarly, where the circumstances are sufficient to put a reasonably prudent man on inquiry, and the principal nevertheless ratifies his agent's unauthorized act without seeking to discover the true state of affairs, he is bound; for where the situation naturally and reasonably suggests that the principal should make an inquiry, and he fails to do so, he will be deemed in law to be possessed of such facts as the inquiry would have disclosed."

Conclusion.

Appellees believe that this case is completely governed by the tariff provisions under the authority of the *Hooker* and *Woodbury* cases. Nevertheless, however, even if sole reliance were placed on the declaration of value, there also seems to be no genuine issue as to any material fact, but on the contrary the facts taken most favorably toward Appellant's contention still demand the entry of summary judgment against him as a matter of law.

Respectfully submitted,

MALCOLM DAVIS,

Attorney for Appellees.

No. 15,069

IN THE

United States Court of Appeals

For the Ninth Circuit

ZENOBIA PERKINS,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

On Appeal from the District Court of the United States for the District of Alaska, Fourth Judicial Division.

BRIEF FOR APPELLEE.

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BRIEF FOR APPELLEE.

JURISDICTION.

The jurisdiction of the District Court below was based upon the Act of June 6, 1900, c. 786, Section 4, 31 Stat. 322, as amended, 48 U.S.C. 101.

The jurisdiction of this Court of Appeals is invoked pursuant to the Act of June 25, 1948, c. 646, 62 Stat. 929, as amended, 28 U.S.C. 1291.

COUNTERSTATEMENT OF THE CASE.

At 1:00 A.M. on April 6, 1955, Staff Sergeant Gerald W. Griffin, who was an air policeman attached to the Office of the Provost Marshal at Ladd Air Force Base,

went to the Territorial Police Office located at 1325 South Cushman Street in Fairbanks, Alaska. There, Emery Chappel, a Territorial Police Officer, gave Griffin sixty dollars consisting of two twenty dollar bills and four five dollar bills. (TR 52.) Each bill was marked with a cross in the upper right hand numeral. After the bills were placed in a wallet, they were dusted with gentian violet, a detection powder which turns purple when touched by a person's hand because moisture is present. Chappel also gave Griffin ten dollars to use in buying drinks so that it would not be necessary to remove any money from the wallet.

Griffin was then taken by the officers to South Cushman where he left the vehicle and walked across the field to the Birdland Bar. Upon entering the bar at 2:05 A.M., he saw Ed Merk, the bartender, Ruby, Vicky, and the Princess (appellant). (TR 16.) He bought himself and the three girls a drink from the ten dollars and engaged in conversation with the appellant. The Princess wanted to know whether he wanted to have a little fun. Griffin testified, "so I told her that I didn't have but a few dollars and it had to last me the rest of the month so when I opened the wallet she made the statement, well, I had plenty of money because she had seen it in there . . ." (TR 19.) Griffin feigned drunkenness and laid his head on the bar. The appellant talked with Floyd West, another patron at the bar, and asked him to go with her. When they started toward the rear of the bar, the appellant came back and shook Griffin a

couple of times and said, "Where is your wallet, honey?". When she received no response, appellant took the wallet out of his jacket pocket. (TR 22.) She said, "Well, I will keep it for him. It is only eleven dollars anyway", then left the bar with Floyd West. Griffin pretended to be sick and left the bar to notify the police officers, who had it under surveillance. Chappel testified that Griffin appeared in front of the bar at 4:45 A.M. The officers drove to the Birdland and got the information from Griffin as to what took place. (TR 57.) Then, they entered the bar, but the appellant was not there. Chappel asked the owner, Ed Merk, where the appellant was. Finally, Merk went into the house behind the bar and appellant came out with the wallet. The officer had made a previous demand for the money from Merk. (TR 62.) However, it was thirty minutes before she appeared. (TR 78.) At that time, Chappel saw the wallet in her hand and asked for it, but appellant did not give it to him until she had entered the bar. (TR 60.) It was daylight and the sun was out. (TR 64.) Chapple observed that the purple stain was on her hands. (TR 64.) The bills in the wallet were wrinkled and purple stain was apparent to the officer, (TR 60), but he did not notice the wallet being damp. (TR 71, 72.)

Officer Dankworth saw the appellant come out of the house behind the Birdland Bar. He also testified that the appellant had a wallet at that time underneath a brown handbag. (TR 91.)

Lucille Ashton, a matron at the Federal Jail, testified that she saw the appellant on April 6, 1955, and ob-

served a purple stain on her left breast, her brassiere and hands. (TR 91.)

Appellant claims that the wallet was on the bar when Griffin left, that she counted the money inside and gave it to the bartender. (TR 112.) Ed Merk, owner of the bar and employer of appellant, testified that the wallet was in the bar. He also testified that he had been in his house once or twice before the officers noticed the stain on his hand. (TR 191.) William Newkirk testified that he thought the wallet was on the bar when Griffin left (TR 150), and Ed Merk threw it behind the bar where he kept the glasses. Leon Urban also testified for appellant and stated that Griffin was showing some pictures at the bar. (TR 138.)

A complaint was filed before the U. S. Commissioner on April 6, 1955, charging the appellant with the crime of larceny. Under the Territorial Statute, if the amount is less than one hundred dollars, it is a misdemeanor. On April 29, 1955, a jury trial was held before the United States Commissioner. The jury returned a verdict of guilty. Appellant appealed to the District Court. On August 8, 1955, the case was tried in the District Court and the jury returned a verdict of guilty.

SUMMARY OF THE ARGUMENT.

Appellant took a wallet containing sixty dollars from the possession of Gerald Griffin at the Birdland Bar. She then went to the house of Ed Merk, which

was located behind the Birdland. After thirty minutes had elapsed, Merk went in after her. The appellant appeared with the wallet in her hand. Officer Chappel asked her for the wallet outside the bar, but she did not give it to him until they were inside. Her hands were stained purple from the detection powder. The jury could reasonably draw the inference that she had deposited the bills in her bra and that caused the brassiere to have purple marks on it, and this would also account for the purple stain on her left breast. Appellant made the statement to Griffin that he had plenty of money because she had seen it. (TR 19.) Yet, she later made the selfserving declaration, "Well, I will keep it for him. It is only eleven dollars anyway." Considering the evidence, the Court did not err in denying appellant's motion for a judgment of acquittal at the close of the plaintiff's case.

The appellant denied she stole the wallet and took it to the house at the rear of the Birdland Bar. Whether the appellant had the intent to steal was a question of fact for the jury to decide and the Court properly allowed the case to go to them for their decision.

Appellant's instruction number 1 was adequately covered by the Court's instruction number III. (TR 251.)

A complaint was filed before the United States Commissioner charging the appellant with the crime of larceny in violation of Section 65-5-41 of the Alaska Compiled Laws Annotated, 1949, as amended. Section 65-5-41, ACLA, 1949, was amended by Chapter 61, Session Laws of Alaska, 1955, (see appendix), wherein

the property stolen must exceed in value one hundred dollars before the crime of larceny can be a felony. Counsel raised an objection for the first time in the District Court that the proof showed a larceny from the person, which is a felony under the territorial statutes. The appellant cannot complain that she should have been convicted of a felony instead of a disdemeanor.

Appellant has failed to show in what manner the instructions were prejudicial. The question of circumstantial evidence was raised when counsel for appellant requested an instruction on circumstantial evidence. (TR 233, 234.)

Mr. Taylor argued entrapment in the lower court, but when confronted with the fact that the government was prepared to show that complaints had been received by the Territorial Police in regard to appellant rolling patrons at the bar in accordance with the decision in *Trice v. U. S.*, 211 F. 2d 513 (9th Cir. 1954), he denied that entrapment was his defense. (TR 8.) Now, he raised this argument before this Court without the Government having an opportunity to show that the officers were not out entrapping an innocent person. *Willie Earl Frazer v. U. S.*, No. 14,898 (9th Cir. May 8, 1956).

ARGUMENT.

I.

APPELLANT'S MOTIONS FOR ACQUITTAL WERE PROPERLY DENIED.

At the close of the government's case in chief the evidence disclosed that the appellant, while in the Birdland Bar about 5:00 A.M., had taken a wallet containing sixty dollars the property of another from the possession of Gerald Griffin. He had feigned drunkenness after consuming several drinks. She left the bar within six or seven minutes after, making the remark that she would keep it for him as there was only eleven dollars anyway. Earlier in the evening, she had told Griffin that he had plenty of money because she had seen it. (TR 19.) Appellant did not come out of Ed Merk's house at the rear of the bar until Merk had gone in after her, although she knew the police were outside. When she did appear, Officer Chappel saw and asked her for the wallet, but she proceeded into the bar before relinquishing possession to him. Chappel inspected the money and found the bills were partially purple and wrinkled. (TR 60.) It was easily discernible that the money had been handled and one bill had more discoloration than the others. (TR 81, 74.) He also did not notice that the wallet was damp.

Officer Dankworth, who had come to assist Chappel after receiving a call, saw the appellant with the wallet outside the bar and walked inside when the others entered for a distance of fifteen feet. (TR 86.)

The matron at the Federal Jail observed purple stains on appellant's left breast and smudges on the brassiere itself.

If the appellant did not intend to steal the money, why did she take it from the bar into another building. The reasonable thing to do would be leave it with the owner, Mr. Merk. Of course later when she took the stand in her own defense that is exactly what she said happened.

The Court denied the motion for acquittal. (TR 100, 101.) The question whether or not the appellant intended to steal the money was properly left for the jury's deliberation and decision. *Morissette v. U.S.*, 342 U.S. 246, 274.

Appellant then testified that she picked the wallet up from the bar after Griffin had got back around the door. (TR. 112.) She also testified at this time that she said, "Probably not ten or twelve dollars in here anyway". Griffin testified appellant made the statement when she took the wallet. She also said, "Here is the man's wallet. Keep it for him until he gets back". Later she testified, "That is the reason I made the statement that I would keep it for him". (TR 124.) Mr. Merk also testified that the wallet and money was in the bar all the time. Now, at the close of all the evidence an additional conflict presented itself; whether the appellant took the wallet and money to Merk's residence or left it with the owner. The Court again denied the motion for judgment of acquittal.

II.

THE APPELLANT WAS CORRECTLY CHARGED AND CONVICTED OF A MISDEMEANOR UNDER THE LARCENY STATUTE.

Appellant contends the conviction cannot stand because the proof showed a larceny from the person. The complaint charged a misdemeanor under Section 65-5-41, Alaska Compiled Laws Annotated, 1949, as amended. The complaint did not allege from the person as required by Section 65-4-24 of the Alaska Compiled Laws Annotated, 1949.

Counsel was aware that the Government had charged a misdemeanor. (TR 65, 80.) One time he argues that the evidence does not support a conviction for a misdemeanor and on the other hand he urges that this Court reverse on the grounds that the evidence showed the crime to be a felony.

In the case of *People v. Lefkowitz,* 248 N.Y.S. 615, the defendant was charged in an information with the crime of petit larceny. He was found guilty and on appeal argued that if he was guilty of any crime, it was a more serious crime than that for which he was convicted. He contended that he should have been indicted and tried for a felony. The Court in its opinion stated,

> "It is argued that since the information alleges facts which constitute a more serious crime, the defendant may not be prosecuted for the lesser offense. It is well settled that the defendant may be charged with and tried for the offense which the District Attorney believes is the proper charge in such a case." "It is frequently necessary for the district attorney to prosecute for a lesser de-

gree of crime because of the surrounding circumstances. There may be some doubt as to the ability of the People to prove a higher degree of crime and the district attorney may reach that conclusion. Of course, a district attorney should be careful to prosecute for the crime for which the defendant may be convicted. The mere fact that the district attorney failed to do so is not a ground for the reversal of the judgment of conviction. In holding that it may be done, we are not deciding that it should be done."

See:

People v. Stein, 80 N.Y.S. 847;

People v. Crote, 153 N.Y.S. 631, 632, affirmed 170 App. Div. 898, 154 N.Y.S. 1137.

In *People v. Goldberg, et al.,* 109 N.Y.S. 906, 908, the Court said,

"If the defendants could have been convicted of an attempt to commit robbery, the fact that the district attorney saw fit to prosecute them for a lesser crime is certainly no reason that a conviction for the lesser crime should be reversed."

III.

THE EVIDENCE IS SUFFICIENT TO SUPPORT THE VERDICT.

Appellant contends the evidence does not sustain the verdict. In support of this point the Court is asked to consider the testimony of the witnesses for the defense as stating the true facts of the case. The credibility of witnesses is a matter for the jury to decide. *Gage v. U. S.*, 167 F. 2d 122, 124 (9th Cir. 1948). It is apparent that the jury believed the evi-

dence produced by the appellee. The evidence necessary to support the conviction has been set forth in the appellee's counterstatement of the case.

IV.

THE COURT DID NOT ERR IN THE INSTRUCTIONS ON THE ELEMENTS OF THE CRIME.

The Court included in instruction number three the elements of the crime of larceny. (TR 251, 252.) In the common law appellant would find some support for the argument that an intent to appropriate the property to her own use must exist before a finding of guilty could be returned. This element has not been uniformly favored by the Courts, and according to the weight of modern decisions the element of personal gain to the taker is not essential. It is regarded as sufficient if there is an intention to permanently deprive the owner of his property. See Note, 12 ALR 804. The territorial statute set forth in the appendix does not require this element alleged as error by appellant.

V.

THE COURT DID NOT COMMIT PREJUDICIAL ERROR IN ITS INSTRUCTION TO THE JURY.

Appellant contends the Court committed prejudicial error in referring to an indictment and the use of the word felonious, when describing the taking. Counsel did not object to these instructions in the trial Court as required by Rule 30 of the Federal Rules of Crimi-

nal Procedure. Now he cannot assign as error the use of the words indictment and felonious unless this Court is confronted with an extraordinary situation that would justify a disregard of the rule. *J. A. Herzog v. U. S.,* No. 14,611 (9th Cir. Decided May 29, 1956).

The Court did not err in giving instruction number nine defining direct and circumstantial evidence. (TR 256, 257.) Even if there were no circumstantial evidence for the jury to consider in this case, which is not correct because evidence of intent must necessarily be circumstantial, the Court's instruction number fifteen would be sufficient to cure the alleged error. (TR 260.) The instructions considered together fairly informed the jury of the standards to apply to the larceny charge. *Elwert v. U. S.,* No. 14,846 (9th Cir. Decided March 22, 1956).

CONCLUSION.

For the reasons set forth above, appellee requests this Court to affirm the judgment of the Court below.

Dated, Fairbanks, Alaska,
July 16, 1956.

Respectfully submitted,

GEORGE M. YEAGER,
United States Attorney,

PHILIP W. MORGAN,
Assistant United States Attorney,

Attorneys for Appellee.

(Appendix Follows.)

Appendix.

Appendix

Session Laws of Alaska, 1955.

Chapter 61

AN ACT

Amending 65-5-41 ACLA 1949, pertaining to larceny; and declaring an emergency. Be it enacted by the Legislature of the Territory of Alaska:

Section 1. Section 65-5-41 ACLA 1949 is hereby amended to read as follows:

Sec. 65-5-41. *Larceny of money, etc.: Description in indictment.* That if any person shall steal any money, goods, or chattels, or any Government note, or bank note, promissory note, or bill of exchange, bond, or other thing in action, or any book of accounts, order, or certificate, concerning money or goods, due or to become due or to be delivered, or any deed or writing containing a conveyance of land or any interest therein, or any bill of sale, or writing containing a conveyance of goods or chattels or any interest therein, or any other valuable contract in force, or any receipt, release, or defeasance, or any writ, process, or public record, the property of another, such person shall be deemed guilty of larceny, and upon conviction thereof, if the property stolen shall exceed in value one hundred dollars, shall be punished by imprisonment in the penitentiary not less than one nor more than ten years; but if the property stolen shall not exceed the value of one hundred dollars, such person, upon conviction thereof, shall be punished by imprisonment in the county jail not less than one month

nor more than one year, or by fine not less than twenty-five nor more than one hundred dollars; Provided, That in all prosecutions for the larceny of money wherein an exact description of the number and denomination of the coin or other money taken cannot be given, it shall be sufficient to allege that the same was lawful money of the United States, or of any other country or countries as the case may be, and the value thereof in money of the United States.

Section 2. An emergency is hereby declared to exist and this Act shall take effect immediately upon its passage and approval.

No. 15071

United States
Court of Appeals
for the Ninth Circuit

MAUREEN GARDNER,

Appellant,

vs.

J. J. NEWBERRY CO., INC.,

Appellee.

Transcript of Record

Appeal from the United States District Court for the District of Idaho, Southern Division.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.—4-6-56

No. 15071

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF ATTORNEYS

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In the United States District Court for the District of Idaho, Southern Division

No. 3167

MAUREEN GARDNER,

Plaintiff.

vs.

J. J. NEWBERRY CO., INCORPORATED, a Foreign Corporation,

Defendant.

AMENDED COMPLAINT

Plaintiff Maureen Gardner complains and alleges:

I.

That the defendant J. J. Newberry Co., Incorporated, is a foreign corporation, operating in Boise, Ada County, Idaho, and engaged in the business of selling miscellaneous merchandise, including parakeets.

II.

That the jurisdiction of this court is invoked under Title 28 U.S.C., 1952 Ed., Chapter 85, Sections 1331-1332, granting District Courts of the United States original jurisdiction in all civil actions where a matter in controversy exceeds the sum of $3,000.00, exclusive of interest and costs, and is between citizens of different states, to wit: Plaintiff, of Oregon, and defendant, of Virginia.

III.

That on December 24, 1954, plaintiff purchased of defendant a parakeet, which defendant had

theretofore offered for sale to the general public in its store in Boise, Idaho, and defendant by so offering said parakeet for sale intended that said parakeet should and would be consumed and used by the purchaser and others thereof as a pet. That defendant thereby impliedly warranted and represented that said parakeet was pure, harmless and wholesome and safe to all persons who might come in contact with the same and defendant knew that such purchaser would rely on the implied warranty and representation as aforesaid; that said parakeet was impure, contaminated and infected with a disease called psitticosis, or parrot's disease, and not reasonably fit for the purpose for which it was purchased and would be used, and the same was not of merchantable quality; that it was within the knowledge of the defendant that said parakeet was to be sold to the general public, of which plaintiff was a member and used by her and others, and defendant then and there impliedly warranted the same to be in all respects fit and proper for the use described herein, and plaintiff relied upon said implied warranty but the same, when sold to plaintiff, was unfit because of the psittocosis, with which it was then infected.

IV.

That plaintiff, by reason of the aforementioned, contracted psitticosis, and suffered greatly in body and mind and limb, and required the services of physicians and surgeons to cure her of the contracted malady, which rendered her sick, lame and sore, with ensuing disability.

V.

That plaintiff did not learn or have notice that the parakeet was infected with psitticosis until early in March, 1955, and thereafter, on or about March 15, 1955, plaintiff, through her agent, gave oral notice to defendant in Boise, Idaho, of her contraction of psittocosis and breach of said implied warranty, as alleged herein.

VI.

That by reason of the premises, plaintiff has been damaged in the sum of $3,500.00.

Wherefore, plaintiff prays judgment against the defendant in the sum of $3,500.00, together with her costs and disbursements.

/s/ WALTER M. OROS,

/s/ JOSEPH IMHOFF, JR.,
Attorneys for Plaintiff.

Receipt of copy acknowledged.

[Endorsed]: Filed August 30, 1955.

[Title of District Court and Cause.]

MOTION TO DISMISS AMENDED COMPLAINT

Comes, Now, Defendant and moves to dismiss the amended complaint of the Plaintiff herein upon the ground and for the reason that the same does not

state a claim against Defendant upon which relief can be granted.

Dated: August 30, 1955.

RICHARDS, HAGA & EBERLE,

By /s/ J. L. EBERLE,
Attorneys for Defendant.

Receipt of copy acknowledged.

[Endorsed]: Filed August 31, 1955.

In the United States District Court for the District of Idaho, Southern Division.

No. 3167

MAUREEN GARDNER,

Plaintiff,

vs.

J. J. NEWBERRY CO., INCORPORATED, a Foreign Corporation,

Defendant.

ORDER

This action is before this Court on a motion by the defendant corporation to dismiss the plaintiff's complaint. Oral argument having been waived, the motion is presented on briefs of counsel.

Plaintiff is a citizen of Oregon. Defendant corporation was incorporated in Virginia, and is doing

business in Idaho. Plaintiff, in her amended complaint, seeks $3,500.00 damages as recompense for disabilities allegedly caused by contracting psitticosis from a parakeet purchased by plaintiff from defendant corporation in its Boise, Idaho, store. This Court has jurisdiction of this action by virtue of 28 U.S.C.A., § 1332.

There is no implied warranty of soundness arising in the sale of animals, and it has been held that, where the seller does not know of a latent defect in the animal, there is no implied warranty as to soundness. 77 C.J.S., Sales, §330 (2). "As a general rule, the doctrine of caveat emptor applies to the sale of animals, and there is no implied warranty of soundness, of freedom from disease, or of the breeding qualities of the animal sold, even though purchased for breeding purposes to the knowledge of the seller." 46 Am. Jur., Sales, §393. See also: 2 Am. Jur., Animals, §38.

The Supreme Court of Idaho, in McMaster v. Warner, 44 Idaho 544, 258 P. 547, decided the question of whether an implied warranty of fitness is raised by the sale of an animal. Appellant Warner, in January, 1919, purchased a heifer from respondent, then engaged in the business of breeding registered cattle. The heifer was apparently in good health on the day of the sale, but nine months later it became apparent that she was infected with actinomycosis, or lump-jaw. There was conflicting evidence, however, as to whether the heifer contracted the disease prior to or subsequent to the

sale. The Court declared, at pages 551 et sequitur, that:

"We find the general rule as to implied warranty is aptly stated by the Wisconsin court in McQuaid v. Ross, 85 Wis. 492, 39 Am. St. 864, 55 N. W. 705, 22 L.R.A. 187, wherein the court said:

" 'The doctrine of implied warranty appears to be founded on an actual or presumed knowledge by the vendor, as manufacturer, grower, or producer, of the qualities and fitness of the thing sold for the purpose for which it was intended or is desired, so far as such knowledge is reasonably attainable. The rule must be held to have a rational foundation, and to be not of a purely arbitrary character. It does not impute to the seller knowledge as to qualities or fitness which no human foresight or skill can attain, and raise an implied warranty in respect to them, when the vendor or purchaser are in equal condition as to the means of knowledge.'

"In this case we find nothing in the record showing that respondent, McMaster, knew or should have known that this heifer was likely to become infected with lump-jaw.

"The record does not disclose evidence sufficient to sustain a finding of any catalogue representation which failed, or any statement by respondent which could be construed as a warranty which failed, or breach of any implied warranty."

This enunciation of the law is the latest, and apparently the only, decision of the Idaho Supreme

Court on this question, and is controlling in the instant case. Erie R. Co. v. Tompkins, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188.

There is no allegation in the amended complaint that defendant corporation had knowledge of the fact, if such was the fact, that the parakeet purchased by plaintiff was a carrier of, or infected with, psitticosis, or that said bird's body displayed any visible effects of said disease or that the parakeet manifested any characteristics of psitticosis. In fact, although the parakeet was purchased on December 24, 1954, plaintiff, according to her amended complaint, "* * * did not learn or have notice that the parakeet was infected with psittacosis until early in March, 1955 * * *," or more than two months after said purchase.

Evidently the fact, if such was the case, that the parakeet was diseased was not discernible by a visual examination of the bird. Therefore, as defendant corporation did not have "actual or presumed knowledge" of such a defect in the parakeet, if in fact there was such a defect, there was no implied warranty that the bird was free from disease. Defendant corporation, also, made no express warranty as to the parakeet's freedom from disease. Consequently plaintiff's amended complaint does not state a claim against defendant corporation upon which relief can be granted.

Accordingly it is ordered that the motion of defendant corporation to dismiss be, and the same is hereby, granted.

Dated this 5th day of January, 1956.

/s/ FRED M. TAYLOR,
United States District Judge.

[Endorsed]: Filed January 5, 1956.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Maureen Gardner, plaintiff above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit, from that certain Order of Dismissal rendered in favor of the defendant above named and against the plaintiff, such Order being entered on the 5th day of January, 1956, and from the whole thereof.

Dated: This 4th day of February, 1956.

/s/ WALTER M. OROS,
Attorney for Plaintiff.

Receipt of copy acknowledged.

[Endorsed]: Filed February 4, 1956.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

United States of America,
District of Idaho—ss.

I, Ed M. Bryan, Clerk of the United States District Court for the District of Idaho, do hereby cer-

tify that the foregoing papers are that portion of the original files designated by the parties and as are necessary to the appeal under Rule 75 (RCP) to wit:

1. Amended Complaint.
2. Defendant's Motion to Dismiss Amended Complaint.
3. Order Dismissing Amended Complaint, dated and entered January 5, 1956.
4. Notice of Appeal.
5. Statement of Points on Appeal.
6. Designation of Contents of Record on Appeal.

In witness whereof I have hereunto set my hand and affixed the seal of said court, this 6th day of March, 1956.

[Seal] /s/ ED. M. BRYAN,
Clerk.

[Endorsed]: No. 15071. United States Court of Appeals for the Ninth Circuit. Maureen Gardner, Appellant, vs. J. J. Newberry Co., Inc., Appellee. Transcript of Record. Appeal from the United States District Court for the District of Idaho, Southern Division.

Filed March 8, 1956,

Docketed: March 19, 1956.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals
for the Ninth Circuit

Civil Action No. 3167

MAUREEN GARDNER,

Plaintiff-Appellant,

vs.

J. J. NEWBERRY CO., INCORPORATED, a Foreign Corporation,

Defendant-Appellee.

STATEMENT OF POINTS UPON WHICH APPELLANT INTENDS TO RELY

Comes now the appellant, Maureen Gardner, by and through her attorney, and hereby sets forth the points upon which she intends to rely on appeal as follows, to wit:

I.

The Court erred in granting the motion of defendant-appellee to dismiss plaintiff-appellant's amended complaint.

II.

The Court erred in ordering on January 5th, 1956, the dismissal of plaintiff-appellant's amended complaint.

III.

The Court erred in failing to deny defendant-appellee's motion to dismiss plaintiff-appellant's amended complaint.

Dated this 15th day of March, 1956.

/s/ WALTER M. OROS,
Attorney for Plaintiff-Appellant.

Receipt of copy acknowledged.

[Endorsed]: Filed March 19, 1956.

No. 15,071

United States Court of Appeals

For the Ninth Circuit

MAUREEN GARDNER,

Appellant,

vs.

J. J. NEWBERRY CO., INC.,

Appellee.

Appeal from the United States District Court for the District of Idaho, Southern Division.

BRIEF FOR APPELLANT.

WALTER M. OROS,
Idaho Building, Boise, Idaho,
Attorney for Appellant.

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No. 15,071

United States Court of Appeals
For the Ninth Circuit

MAUREEN GARDNER,
Appellant,

vs.

J. J. NEWBERRY CO., INC.,
Appellee.

Appeal from the United States District Court for the District of Idaho, Southern Division.

BRIEF FOR APPELLANT.

JURISDICTION.

Jurisdiction is conferred by 28 U.S.C.A., section 1332. Allegations of existence of jurisdiction appear in plaintiff's amended complaint. (R. 3.) The facts disclosing the basis upon which it is contended that the trial court had jurisdiction are:

(1) Plaintiff is a citizen of Oregon. (R. 3.)

(2) Defendant is a citizen of Virginia, operating in the State of Idaho and engaged in the business of selling miscellaneous merchandise, including parakeets. (R. 3.)

(3) The amount in controversy is $3,500.00 (R. 5), exclusive of costs and interest. (R. 3.) The District Court found jurisdiction. (R. 7.)

Jurisdiction of the Circuit Court of Appeals is based upon the fact that on January 5, 1956 the trial court entered an order dismissing plaintiff's amended complaint and notice of appeal therefrom was filed on behalf of plaintiff-appellant on February 4, 1956. (R. 10.)

Jurisdiction of appeal for the case is conferred by 28 U.S.C.A., sections 1291, 1294 and 2107 and Rule 73 (RCP).

STATEMENT.

Appellant brings this action for personal injuries against appellee on breach of implied warranties growing out of the sale to her of a parakeet. She alleges, "defendant by so offering said parakeet for sale intended that said parakeet should and would be consumed and used by the purchaser and others as a pet. That defendant thereby impliedly warranted and represented that said parakeet was pure, harmless and wholesome and safe * * *; that said parakeet was impure, contaminated and infected * * * and not reasonably fit for the purpose for which it was purchased and would be used, and the same was not of merchantable quality; * * * and defendant then and there impliedly warranted the same to be in all respects fit and proper for the use described herein, and plaintiff relied upon said implied warranty but the same,

when sold to plaintiff, was unfit because of the psittacosis with which it was then infected." (R. 4.)

Appellant further alleged notice of the psittacosis in March, 1955 and the giving of oral notice to defendant of the breach of implied warranty. (R. 5.)

Appellee moved to dismiss the amended complaint (R. 6), and on January 5, 1956 the action was ordered dismissed. (R. 10.)

STATUTES INVOLVED.

The State statutes involved are those sections under the Uniform Sales Act of the State of Idaho, Title 64, Chapters 1-6, Idaho Code, set forth in the Appendix, infra.

The Uniform Sales Act became effective in Idaho on January 1, 1920, and is Chapter 149, p. 443, et seq., 1919 Session Laws.

QUESTION PRESENTED.

If, at the time of the sale, a parakeet is allegedly infected with psittacosis, does the purchaser thereof, who subsequently contracts the disease from the bird, have a cause of action against the seller thereof, upon the theory of breach of implied warranty of merchantability and unfitness for the purpose for which the parakeet was purchased.

SPECIFICATIONS OF ERROR.

I.

The Court erred in granting the motion of defendant-appellee to dismiss plaintiff-appellant's amended complaint.

II.

The Court erred in ordering on January 5, 1956, the dismissal of plaintiff-appellant's amended complaint.

III.

The Court erred in failing to deny defendant-appellee's motion to dismiss plaintiff-appellant's amended complaint.

PROPOSITIONS OF LAW RELIED ON AND CITATION OF CASES.

I.

Generally speaking, this Court is bound by law as declared by the Supreme Court of the State where the action arose.

Sanger v. Lukens (9th Cir.), 26 Fed. (2d) 855;

Lincoln Co. v. Huron Holding Corp. (9th Cir.), 111 Fed. (2d) 438;

Boise Payette Lbr. Co. v. Halloran (9th Cir.), 281 Fed. 818;

Erie R. Co. v. Tompkins, 304 U.S. 64, 58 S. Ct. 817, 82 L. ed. 1188;

Standard Acc. Co. v. Winget (9th Cir.), 197 Fed. (2d) 97.

II.

Where the state decisions are in conflict or do not clearly establish what the local law is, the federal court may exercise an independent judgment and determine the law of the case.

Christian v. Waialua Agr. Co. (Hawaii), 93 Fed. (2d) 603, rehr. denied 59 S. Ct. 240, 305 U.S. 673, 83 L. ed. 436;

New York Life v. Ruhlin, 25 Fed. Supp. 65;

Ruhlin v. New York Life, 58 Sup. Ct. 860, 304 U.S. 202, 82 L. ed. 1290;

Hamilton v. Loeb, 179 Fed. (2d) 728, 186 Fed. (2d) 7;

In re Phoenix Hotel, 13 Fed. Supp. 229, 83 Fed. (2d) 724;

Bodenheimer v. Confed, Mem. Assn., 68 Fed. (2d) 507, affg. 5 Fed. Supp. 526;

Dernberger v. B. & O., 243 Fed. 155, 234 Fed. 405.

III.

In the absence of a decision laid down by the State Court, the Circuit Court will apply the rule previously made by it.

Hagan & Cushing Co. v. Wash. W. P. Co. (9th Cir.), 99 Fed. (2d) 614.

IV.

Judicial opinions are only authoritative on the facts on which they are founded, and general expressions

must be considered and construed in the light of this rule.

Bashore v. Adolf (Ida.), 238 Pac. 534;
Eldridge v. Black C. Irr. Co. (Ida.), 43 Pac. (2d) 1052;
Application of Kaufman (Ida.), 206 Pac. (2d) 528;
Pore, Inc. v. Comm. (Mich.), 33 N.W. (2d) 657;
U. S. v. One-Ford Two-Door (D.C. Ida.), 69 Fed. Supp. 417;
Bradshaw v. Seattle (Wash.), 264 Pac. (2d) 265, 42 A.L.R. (2d) 800.

V.

Stare decisis will not be applied in any event to perpetuate error.

State v. Ballance (N.C.), 51 S.E. (2d) 731, 7 A.L.R. (2d) 407;
Bank v. Doschades (Ida.), 279 Pac. 416;
Kerr v. Finch (Ida.), 135 Pac. 1165;
Dale County v. Brigham (Fla.), 47 So. (2d) 602, 18 A.L.R. (2d) 602;
Hanks v. McDanell (Ky.), 210 S.W. (2d) 784, 17 A.L.R. (2d) 1;
Woods v. Lancet (N.Y.), 102 N.E. (2d) 691.

VI.

Reasons for the doctrine of *stare decisis* are less strong in cases where vested property rights are not disturbed.

Bank v. Doschades (Ida.), 279 Pac. 416;
Kabatchnick v. Hanover-Elm Corp. (Mass.), 103 N.E. (2d) 692, 30 A.L.R. (2d) 918.

VII.

"The purchase of an animal with the knowledge of the seller that it is being bought for a particular purpose gives rise to a warranty of fitness for such particular purpose where the buyer relies upon the seller's skill or judgment that the animal is fit for such purpose."

46 Am. Jur. (Sales), Sec. 393, p. 567;
Moeckel v. Diesenroth (Mich.), 235 Pac. 157;
Snowden v. Waterman (Ga.), 31 S.E. 110;
Woolsey v. Ziegler (Okla.), 123 Pac. 164;
Trousdale v. Burkhardt (Iowa), 224 N.W. 93;
Alford v. Kruse (Minn.), 235 N.W. 903;
Barton v. Dowls (Mo.), 285 S.W. 988;
Renfrow v. Citizens' State Bank (Ind.), 158 N.W. 919;
Latham v. Powell (Va.), 103 S.W. 638.

VIII.

There not only can be an implied warranty in the sale of an animal or bird for the breach of which an action will lie, but also in such cases where the animal or bird is leased.

Idaho Code, Sec. 64-115;
Idaho Code, Sec. 64-309;
Idaho Code, Sec. 64-507;
Koser v. Hornbeck (Ida.), 265 Pac. (2d) 988.

IX.

Courts have, without hesitation, permitted recovery for breach of implied warranty in cases involving the sale of contaminated or impure food.

Vaccarino v. Cozzubo (Md.), 31 A. (2d) 316;
Pellettier v. Dupont (Md.), 128 A. 184;

Catalanello v. Cudahy, 27 N.Y.S. (2d) 637;
Ward v. Great Atlantic (Mass.), 120 N.E. 225;
Cheli v. Cudahy (Mich.), 255 N.W. 414;
Nelson v. West Coast Dairy (Wn.), 105 P. (2d) 76;
Williams v. Coca Cola (Ill.), 98 N.E. (2d) 164;
Amdal v. Woolworth (Iowa), 84 Fed. S. 657;
Vogel v. Thrifty Drug (Cal.), 272 P. (2d) 1;
Ryan v. Progressive Stores (N.Y.), 175 N.E. 105, 22 N.C.C.A. (N.S.) 573;
Klein v. Duchess Sand. Co. (Cal.), 86 Pac. (2d) 858.

X.

Courts have, without hesitation, permitted recovery for breach of implied warranty in cases involving the sale of wearing apparel.

Rogiers v. Gilchrest Co. (Mass.), 45 N.E. (2d) 744;
Barrett v. S. S. Kresge Co. (Pa.), 19 A. (2d) 502;
Payne v. White Co. (Mass.), 49 N.E. (2d) 425;
Zirpola v. Adam Hats (N.J.), 4 A. (2d) 73;
Ringstad v. Magnin & Co. (Wash.), 239 P. (2d) 848;
Deffebach v. Lansburgh & Bros., 150 Fed. (2d) 591, 12 N.C.C.A. (N.S.) 204.

XI.

Courts have, without hesitation, permitted recovery for breach of implied warranty in cases involving the

sale of various chattels, including rabbits infected with a contagious disease.

Haut v. Kleene (Ill.), 50 N.E. (2d) 855;

Bianchi v. Denholm & McK. Co. (Mass.), 19 N.E. (2d) 697;

Smith v. Burdine (Fla.), 198 So. 223;

Kruper v. P. & G. Co. (Ohio), 119 N.E. (2d) 605, 4 N.C.C.A. (N.S.) 709.

XII.

One purchasing food or other commodity for human consumption relies upon the wisdom of the seller as to the quality of the product, and this is a necessary inference from the relation of the parties.

Ward v. Great At. & P. Tea Co. (Mass.), 120 N.E. 225;

Ringstad v. Magnin Co. (Wash.), 239 P. (2d) 848;

Blanchard v. Kronick (Mass.), 169 N.E. 438.

XIII.

The purchaser should be protected for breach of implied warranty. The retailer may recoup from the manufacturer if there is liability.

Griffin v. James Butler Gro. (N.J.), 156 A. 636;

Higbee v. Giant Food Shop. (Va.), 106 Fed. Supp. 586;

Ryan v. Progressive Foods (N.Y.), 175 N.E. 105.

XIV.

Lack of knowledge at the time of the sale of the defect or unwholesomeness of the commodity on the part of the seller and purchaser is no reason to deny recovery to the purchaser on breach of implied warranty.

Bianchi v. Denholm (Mass.), 19 N.E. (2d) 697;
Young v. Great At. Pac. T. Co. (Pa.), 15 Fed. Supp. 1018;
Vaccarino v. Cozzubo (Md.), 31 A. (2d) 185;
Baum v. Murray (Wash.), 162 P. (2d) 801.

SUMMARY OF ARGUMENT.

I.

The case of *McMaster v. Warner* (Ida.), 258 Pac. 547, is not a precedent to be applied herein because the facts in the *McMaster* case and the case at bar are entirely dissimilar, and the Uniform Sales Act of the State of Idaho was not then in effect; hence, *Erie R. Co. v. Tompkins* is inapplicable.

II.

If there is any precedent to be applied, the latest expression of the Supreme Court as announced in *Koser v. Hornbeck* (Ida.), 265 Pac. (2d) 988 should be applied.

III.

On analogy of the food cases, in which recovery was allowed on breach of implied warranty, appel-

lant herein has stated a claim upon which relief may be granted.

ARGUMENT.

I.

The Honorable District Judge, in his order, was of the opinion that the case of *McMaster v. Warner* (Ida.), 258 Pac. 547, was decisive of this case, and that under the ruling of *Erie R. Co. v. Tompkins,* he was required to follow such case. In this, appellant does not concur.

The order cites as authority, 46 Am. Jur. (Sales), 393, to the effect that "caveat emptor" applied to the sale of animals, and there is no implied warranty of soundness, of freedom of disease, or of the breeding qualities of the animal sold, even though purchased for breeding purposes to the knowledge of the seller. Apparently, the Court overlooked the rest of the paragraph therein, as follows:

> "However, the purchase of an animal with the knowledge of the seller that it is being bought for a particular purpose gives rise to a warranty of fitness for such particular purpose where the buyer relies upon seller's skill or judgment that the animal is fit for such purpose. This rule applies to a purchase of animals with the knowledge of the seller that they are being bought for the purpose of immediate slaughter or resale after fattening by the buyer, or for the purpose of use as stock animals. This rule also applies to the purchase of a horse for the purpose of work

or driving, and to the purchase of a cow for dairy purposes, and to the purchase of an animal for breeding purposes." (46 Am. Jur., Sales, Sec. 393.)

Referring specifically to the *McMaster* case, supra, it is not a precedent herein for the following reasons:

1. The animal sold did not apparently develop its defect until many months after the purchase.

2. The damages claimed were for infecting the remaining herd.

3. That the disease with which the animal was allegedly infected was not contagious.

4. "In this case we are dealing with a heifer purchased after and upon a personal inspection by the buyer."

5. The *McMaster* case does not deal with the sale of a commodity or chattel to be used by human consumption.

6. The Sales Act of the State of Idaho, under which the case at bar must be determined, was not in force at the time of the sale in the *McMaster* case, to-wit: January, 1919.

In the *McMaster* case it was observed:

> *"But in this case we are dealing with a heifer purchased after and upon a personal inspection by the buyer.* She dropped and nursed her calf, and upon this heifer, the infection complained of was not discovered until some eight or nine months after the sale. And here we are without opinion ventured by any of the veterinarians that

she was not sound at the time of the sale." (Italics ours.)

Accordingly, the statements in the *McMaster* case are pure dicta and unnecessary to the decision, because the buyer actually examined the animal before or at the time of the sale, and are not binding in the case at bar. Furthermore, there was no substantial evidence that the animal was not healthy at the time of the sale. Under the facts of the *McMaster* case, having made an inspection of the animal before the sale, there could be no reliance by the buyer upon the seller's skill or judgment, thus precluding application of implied warranties.

Where an authority is in point, this Court is bound by the law declared by the Supreme Court of the state where the cause of action arose (Propositions of Law I); however, where the state decisions are in conflict or do not clearly establish what the law is, this Court may exercise an independent judgment and determine the law of the case. (Propositions of Law II.) Where the precise point has not been determined, and the point is one of novel impression within the state, this Court should determine the principle of law involved with the aid of such persuasive authorities as are available (*Smith v. Penn. Cent. Airlines,* 76 F. Supp. 940, 6 A.L.R. (2d) 521; *Baruch v. Sapp* (4th Cir.), 178 Fed. (2d) 382), but it should not adopt general or loose language of one opinion and apply it to a case on dissimilar facts.

There is much general language in the *McMaster* case, completely unnecessary to the decision. "* * *

the generality of the language used in an opinion is always to be restricted to the case before the Court, and is only authority to that extent." (*Stark v. McLaughlin* (Ida.), 261 Pac. 244.)

There is a pronounced line of demarkation between what is said in an opinion and what is decided by it * * *" (*Bashore v. Adolf,* supra).

Judicial opinions are only authoritative on the facts upon which they are founded and general expressions (in an opinion) must be considered and construed in the light of this rule. (Propositions of Law IV.)

Judicial opinion should be considered only in reference to the particular case under consideration, and limited to those points raised by the record, considered by the Court, and necessary to the determination of the case. (*Stark v. McLaughlin* (Ida.), 261 Pac. 244; *Bashore v. Adolf,* supra; *North Side Canal v. Idaho Farms Co.* (Ida.), 96 Pac. (2d) 232.)

Thus, it is respectfully observed that the loose language used in the *McMaster* case was unnecessary to the opinion and ultimate outcome, and the same is not a precedent for the case under consideration, and that *Erie R. Co. v. Tompkins,* supra, is not applicable. In the absence of a state decision this Court can apply the law as it gleans the same to be.

II.

Should this Court decide that *McMaster v. Warner* is of some significance, and that the generalities stated therein are of some persuasion, then appellant sub-

mits that of equal dignity and weight are the observations in *Koser v. Hornbeck* (Ida. 1954), 265 Pac. (2d) 988, in which the Idaho Supreme Court, in passing upon a suit involving personal injuries arising out of the bailment of a horse, stated:

> "* * * one who lets a horse for hire, although not an insurer of the horse's fitness, is, under an obligation, sometimes spoken of as an implied warranty, to furnish an animal which is reasonably safe for the purpose known to be intended * * *."
>
> "It has been held that such an action may be brought either in contract for a breach of an implied warranty of fitness, or in tort for negligence in furnishing an unsafe animal."

The aforementioned are the *latest* expressions of that Court in the law of implied warranties, and if there is sound reason to apply such law to bailments, there is all the more reason to hold it applicable to a sale, as we have in this case.

If the *McMaster* case is a precedent, the Supreme Court of the State of Idaho said many years ago in relation thereto, "precedent is strongly persuasive with this court but not controlling, and if devoid of reason and justice, will not be followed." (*Kerr v. Finch* (Ida.), 135 Pac. 1165.)

Speaking of "stare decisis", the following quotations are, in appellant's opinion, particularly applicable:

> "The appellant relies strongly on the principle of stare decisis to maintain his position that the common law rule still exists undisturbed in Ken-

tucky. It must be admitted that stare decisis supports his position, but it seems to us the words of Mr. Justice Brandeis in State of Washington v. W. C. Dawson & Co., 264 US 219, 44 S. Ct. 302, 68 L. ed. 646, are applicable here:

> 'Stare decisis is ordinarily a wise rule of action. But it is not a universal, inexorable command. The instances in which the court has disregarded its admonition are many.' "
>
> *Brown v. Gosser* (Ky.), 262 S.W. (2d) 480, 43 ALR (2d) 626.

"Notwithstanding the rule of stare decisis, or inclination to follow precedents, the courts have the power, and frequently exercise it, of departing from rules which have been previously established. The strong respect for precedent which is ingrained in our legal system is a reasonable respect which balks at the perpetuation of error, and it is the manifest policy of our courts to hold the doctrine of stare decisis subordinate to legal reason and justice and to depart therefrom when such departure is necessary to avoid the perpetuation of pernicious error. Accordingly, the authority of precedents must often yield to the force of reason and to the paramount demands of justice as well as the decencies of civilized society, and the law ought to speak with a voice responsive to these demands."

14 Am. Jur. 341, Sec. 124 *Courts*;

Hanks v. McDanell (Ky.), 210 S.W. (2d), 784, 17 A.L.R. (2d) 1.

"Our court said, long ago, that it had not only the right, but also the duty to re-examine a ques-

tion where justice demands it * * *. That opinion notes that Chancellor Kent, more than a century ago, had stated that upwards of a thousand cases could then be pointed out in the English and American reports 'which had been overruled, doubted, or limited in their application', and that the great Chancellor had declared that decisions which seem contrary to reason 'ought to be examined without fear, and revised without reluctance, rather than to have the character of our law impaired and the beauty and harmony of our system destroyed by perpetuity of error'. And Justice Sutherland, writing for the Supreme Court in Funk v. United States, 290 US 371, 382, 54 S. Ct. 212, 215, 78 L. ed. 369, said that while legislative bodies have the power to change old rules of law, nevertheless, when they fail to act, it is the duty of the court to bring the law into accordance with present day standards of wisdom and justice rather than 'with some outworn and antiquated rule of the past.' No reason appears why there should not be the same approach when traditional common law rules of negligence result in injustice. * * *"

"The sum of the argument against plaintiff here is that there is no New York decision in which such a claim has been enforced. Winfield's answer to that, see U. of Toronto LJ article, supra, p. 29, will serve: 'if that were a valid objection, the common law would now be what it was in the Plantaganet period'. We can borrow from our British friends another mot: 'When these ghosts of the past stand in the path of justice clanking their mediaeval chains the proper course for the judge is to pass through them undeterred.'

> * * * We act in the finest common law tradition when we adopt and alter decisional law to produce commonsense justice."
>
> *Woods v. Lancet* (N.Y.), 102 N.E. (2d) 691, 27 A.L.R. (2d) 1950.

It should be remembered that the case at bar is not dealing with a fixed rule of property and no vested rights can be impaired by ignoring the statements made in the *McMaster* case. Thus, the reasons for the doctrine of *stare decisis* are less strong in a case like the present than in one where rules of property are involved. (*Kabatchnick v. Hanover-Elm Corp.,* (Mass.), 103 N.E. (2d) 692; *First National Bank v. Schodes* (Ida.), 279 Pac. 416; *Hanks v. McDanell* (Ky.), 210 S.W. (2d) 784.)

III.

Assuming there is confusion in Idaho with reference to the law of implied warranty, then this Court is free to apply the law as consonant with good reason and logic, with particular reference to cases from other jurisdictions.

The cases from other jurisdictions involving denial of recovery or recovery on breach of contract growing out of the sale of animals are legion. For example:

An implied warranty that an animal sold is merchantable and reasonably suited to the use intended arises upon the sale thereof, and is breached where it is infected with the germs of a disease unknown

both to the seller and the buyer, which subsequently develops, causing the death of the animal.

Snowden v. Waterman (Ga.), 31 S.E. 110.

A warranty arising from representations made by the seller at the time of sale that a cow was a good milch cow implies the absence of any defect or disease which will impair the animal's natural usefulness for the purpose for which it is purchased, and it is breached by any defect which renders the animal permanently less serviceable, although the defect had not fully developed at the time of the sale.

Woolsey v. Ziegler (Okla.), 123 Pac. 164.

Implied warranty that the cow was fit for breeding purposes, was breached in sale by a breeder of cows of this kind to a buyer who stated that he desired to purchase the animal for this purpose; Uniform Sales Law applied.

Peterson v. Dreher (Iowa), 194 N.W. 53;
Trousdale v. Burkhardt (Iowa), 224 N.W. 93.

A breeder of registered Guernsey cows, who sells them to a purchaser with the knowledge that they are to be used for breeding purposes in building up a thoroughbred herd, and that his herd from which they are sold is infected with contagious abortion, or Bang's disease, the purchaser being ignorant thereof and supposing he is getting cows fit for putting into his herd for the purpose stated, is liable upon an implied warranty that the cows sold are fit for the purpose intended and are not infected with the disease.

Alford v. Kruse (Minn.), 235 N.W. 903.

The sale of hogs as breeding stock raised an implied warranty that the animals were fit for that purpose, which was breached where the hogs were infected with a contagious disease.

Barton v. Dowls (Mo.), 51 A.L.R. 494, 285 S.W. 988.

The sale of a car of live hogs, described as stock hogs, raises an implied warranty that the hogs shall be fit for stock purposes, which is breached by the hogs being unsound and apparently infected with a fatal disease.

Renfrow v. Citizens' State Bank (Ind.), 158 N.W. 919.

A sale of cattle for a purpose which the buyer communicated to the seller (to resell for feeding and fattening) raises an implied warranty that the cattle are fit for this purpose.

Lotham v. Powell (Va.), 103 S.W. 638.

In the cases of wearing apparel, recoveries have been denied and granted on breach of implied warranty. In *Zirpola v. Adam Hat Stores, Inc.* (N.J.), 4 A. (2d) 73, we find this statement:

> "It is well known that many people are immune from certain poisons as well as contagious and infectious diseases, yet it could not be contended by reason thereof that a vendor selling an article infested with disease germs or containing a poisonous substance injurious to the user of the article would not be liable under an implied warranty, unless it could be proved that injury would be the inevitable result of the use of such article

> * * * We think there was sufficient evidence to establish the fact that the poisonous dye was contained in the hat at the time of purchase, and as a result thereof plaintiff was injured."

A person buying a dress over a counter has a right to rely upon the implied warranty that it was fit to be worn, particularly when an inspection of the dress would not disclose unsound condition of the dress, and if she is injured by reason of breach of implied warranty, plaintiff may recover.

> *Payne v. R. H. White Co.* (Mass.), 49 N.E. (2d) 425;
>
> *Rogiers v. Gilchrest Co.* (Mass.), 45 N.E. (2d) 744.

An implied warranty, which would render the defendant seller of a dress liable for personal injuries sustained by the buyer because of the dyes in the dress, was held to be present, although the purchase was made directly from a rack of similar garments. The Court said:

> "We see no distinction in reasoning or principle between the present situation and the foodstuff cases, universally recognized as the subject of implied warranties of fitness for use for the purpose for which the materials or products are sold. Here are cheap garments manufactured and sold in lots of thousands. The manufacturers and retailers are obviously the only ones in a position to control and know the character and effect of the materials used in their manufacture, and no housewife can be expected to risk the chance of poisoning by a substance contained in

an ordinary article of clothing designed and sold expressly for human wear."

Barrett v. S. S. Kresge Co. (Pa.), 19 A. (2d) 502.

Where there was evidence that the plaintiff, not an expert in textiles, purchased a lounging robe made of materials which would burn up in an instant if they came in contact with flame and that the plaintiff was severely burned when she waved a match after lighting a cigarette, the robe being ignited thereby, it was held that the jury should have been instructed that if the robe caught fire and burned as the witnesses testified, there was a breach of implied warranty of fitness, and a directed verdict for the defendant was reversed.

Deffebach v. Lansburgh & Bros., 185 Fed. (2d) 591.

In many cases involving the sale of food which have arisen, the Courts have held or recognized that the circumstances of the sale may show an implied warranty that the article is fit for consumption, and that if it turns out to be unwholesome or poisonous, resulting in sickness of the buyer, the seller is liable either in tort or assumpsit for the injury thus resulting.

There is an implied warranty that food purchased for human consumption is reasonably fit for that purpose. (See Propositions of Law IX.)

Other than the wearing apparel and food cases, recoveries have been allowed.

An implied warranty of fitness, with resultant liability for injury to the plaintiff, was held to be present where the defendant sold face powder containing a substance known to be an irritant to "some" persons' skin, and the plaintiff was injured by use of such power.

Bianchi v. Denholm & McK. Co. (Mass.), 19 N.E. (2d) 697, 121 A.L.R. 460.

Where a woman bought a lipstick from a retailer from which she suffered impairment of health by its use, an implied warranty of fitness and reliance was for the jury from the facts of the sale.

Smith v. Burdine's Inc. (Fla.), 198 So. 223.

So, in just about every conceivable sale of "personal property", there has been recovery allowed against the seller when there is a breach of implied warranty of fitness or merchantability. There are, of course, many cases to the contrary, too, but in the sale of such property which communicates a disease to the purchaser, the Courts are inclined to find breach of an implied warranty. Why is this so? Because the purchaser is not buying a "disease", and he who made the loss possible must suffer that loss.

The appellee says that there is no allegation of "scienter" or knowledge on its part of the existence of the disease in the parakeet, and that it does not impliedly warrant against something that it does not know about. The law is otherwise, however.

That one purchasing from a grocer a can of beans for food relies on the wisdom of the seller as to the

quality of the product is a necessary inference from the relation of the parties.

Ward v. Great At. & P. Tea Co. (Mass.), 120 N.E. 225.

So, too, in the sale of a parakeet.

The seller's knowledge of unfitness of an article sold need not be shown in action against him for damages for breach of implied warranty of fitness.

Bianchi v. Denholm (Mass.), 19 N.S. (2d) 697;

(See Propositions of Law XIV.)

The only use that the plaintiff, in this case, had for the parakeet was that of a pet or companion. The mere fact that she bought it, raised, by implication that it was reasonably fit for that purpose, that it was free of disease, that it could be consumed in that manner.

> "Sufficient information as to the particular purpose for which a garment is required, to raise an implied warranty within the Uniform Sales Act, arises from the fact that the purchaser wanted it for personal wear, tried it on, and obtained the alterations necessary to make it fit."

Flynn v. Bedell Co. (Mass.), 136 N.E. 252.

It has been held that it is not necessary that the buyer, at the time he contracts or proposes to buy, state the purpose for which he requires the goods. If the seller, from the circumstances of the sale, acquires knowledge of the purpose of the goods, it is implied

that the seller warrants them to be reasonably fit for that purpose.

Manchester Liners v. Rea, 2 AC (Eng.) 74, 11 BRC 349.

She relied upon seller's skill and judgment that the bird was reasonably fit and clean for the purpose intended.

Buyer need not show express reliance upon seller's skill or judgment.

Kurriss v. Conrad & Co. (Mass.), 46 N.E. (2d) 12.

> "The fact that the defect in the article furnished rendering it unsuitable for the purpose contemplated could have been discovered by the buyer by a careful examination does not relieve the seller from liability on his warranty, if the buyer did not in fact have knowledge of the defect, and it was not so patent as to be unavoidably brought to his attention; for as has been said, the buyer is not bound to examine, because he has the right to rely upon the judgment of the seller, and to take it for granted the latter has furnished an article answering the terms of the contract."
>
> 46 Am. Jur. Sec. 346, p. 532.

Perhaps one of the outstanding cases of breach of implied warranty, in appellant's opinion, is that of *Ringstad v. V. I. Magnin & Co.* (Wn. '52), 239 Pac. (2d) 848, in which the Court stated:

> "But the amended complaint was drafted with the intent to state a cause of action based upon a breach of an implied warranty of fitness, in re-

liance upon the uniform sales act and specifically Rem. Rev. Stat §5836-15 (1), which is as follows: '(1) Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required, and it appears that the buyer relies on the seller's skill or judgment (whether he be the grower or manufacturer or not), there is an implied warranty that the goods shall be reasonably fit for such purpose.'

Under that subsection there are two prerequisites to an implied warranty of fitness: First, the buyer must make known to the seller, expressly or by implication, the particular purpose for which the article is required; and second, the buyer must rely upon the seller's skill and judgment when he purchases the article. Cochran v. McDonald, 1945, 23 Wash. 2d 348, 161 P. 2d 305. It is obvious that an article of wearing apparel is to be worn, and that purpose must have been known to the seller. *The fact of the sale itself is sufficient to indicate that the seller knew the particular purpose, and thereby satisfies the first prerequisite.* (Italics ours.)

The amended complaint states that the buyer examined the robe '* * * for color, texture, size, style and design, but was totally and wholly uninformed as to the safety factor of the fabric from which the garment was manufactured and the resistance of said fabric to flame or fire; and said plaintiff (buyer, appellant) relied wholly and exclusively upon the defendant (seller, respondent) * * * to market merchandise which was fit for the purposes for which it was intended and safe for public use.'

That is a sufficient allegation of reliance by the buyer on the skill and judgment of the seller on an essential point fit for the required purpose. We therefore hold that the amended complaint sufficiently alleges the two prerequisites to a breach of warranty of fitness as set forth in Rem. Rev. Stat. §5836-15(1)."

* * * * * * *

"Many cases hold that reliance on the seller's skill and judgment may arise by implication from the facts in the case. As was held in Kurriss v. Conrad & Co., Inc., 1942, 312 Mass. 670, 682, 46 N.E. (2d) 12:

'The question is squarely presented whether the plaintiff, by implication, had a right to rely upon the expectation that she should not be sold a dress that contained some deleterious substance, not observable or discoverable upon reasonable examination by her, which would cause her injuries'.

We think it may be assumed that the defendant did not intend to sell and that the plaintiff did not intend to purchase such a garment. * * * Where, as in the case at bar, in a sale over the counter of an article that is open to inspection, but where any practicable inspection would not disclose an unsound condition, the plaintiff, by implication, has a right to rely upon the skill and judgment of the seller.' Quoted and approved in Payne v. R. H. White Co., supra (314 Mass. 63, 49 N.E. (2d) 426).

We hold in accordance with what we believe is the majority, and in any event the better, rule, i.e., that the implied warranty of fitness applies to retail sales of wearing apparel where the prerequisites of Rem. Rev. Stat. §5836-15(1) are met."

In endeavoring to impress the Court upon the merits of her lawsuit, appellant has tried to restrict the cases cited to those in which the subject of the sale has communicated a disease or an infection to the buyer after the sale. Extensive research has disclosed only one case which is in point, *Haut v. Kleene* (Ill., 1943), 50 N.E. (2d) 855, involving the sale of rabbits to plaintiff's wife resulting in her death by the contraction by her of the disease called "tularemia" or rabbit fever. The wife contracted the disease by the handling of the rabbits and not from the consumption of them with the family at mealtime. The Court stated:

> "Plaintiff brought an action against defendants under the Injuries Act to recover for the wrongful death of his wife charging that defendants were negligent in keeping and selling rabbits. Defendants denied liability and during the trial, by leave of court, plaintiff amended his complaint by charging that the rabbits purchased were intended for consumption by the general public and defendants knew they would be prepared for use as food and *thereby impliedly warranted* that the rabbits were 'free from injurious defects in the handling and consumption' of them; that the deceased as a result of handling and preparing the rabbits for food became afflicted with a disease known as tularemia or rabbit fever, from which she died. * * * The court on disposing of these motions entered the judgment appealed from in which it is recited that the matter came on to be heard on the motion of Amy Slad for judgment notwithstanding the verdict of the jury and 'after

arguments of counsel and due deliberation by the Court said motion is sustained as to the negligence and wilful and wanton counts and overruled as to the implied warranty count.' Continuing, the court overruled the motion for a new trial, entered judgment on the verdict against Amy Slad for $2,500 and also entered judgment on the verdict finding the other two defendants not guilty. Amy Slad appeals. The record discloses that on Friday, November 29, 1940, Charles Haut, husband of the deceased, who then lived at 1528 W. 29th Place, Chicago, went into the small retail store of defendant, Amy Slad, and purchased four rabbits from her. He testified that he asked Mrs. Slad if they were good, fresh rabbits and she said they were. There were about 100 skinned rabbits in the store and he had Mrs. Slad pick out four of them for which he paid $1.50; that he took them home, his wife washed them, cut them up in lengths, put them in a pail of vinegar, seasoning and carrots, and then into the ice-box; that she took them out on Sunday, cooked them and he and his family, consisting of himself, his wife and two daughters, ate the rabbits for dinner; that they were very good and they felt no ill effects from them. That about a week before he purchased the rabbits, his wife had cut her finger, that the Monday after they had eaten the rabbits she complained of headache and backache, the doctor was called, she was treated until December 6, 1940, when she was taken to the County Hospital, where she died December 16. The doctors who had treated her described the cut in her hand and gave as their opinion that she died as a result of tularemia, or rabbit poisoning."

Although the case of *Haut v. Kleene* was reversed because of an erroneous instruction, the Court held that defendant, Amy Slad could be held liable on breach of implied warranty on the sale of the rabbits, stating:

> *"But in any event, we are of the opinion that the issue can be submitted as against the defendant, Amy Slad without any confusion."* (Italics ours.)

The *Haut* case, supra, is direct authority for the rule when a seller sells an animal or a bird for human consumption, and such bird or animal is infected with a disease, there is liability on an implied warranty of fitness, even though the disease is contracted by the *handling* of the bird or animal, and the seller knows nothing about the condition of the bird or animal at the time of the sale.

Higbee v. Giant Food Shopping Center, Inc. (Va. '52), 106 Fed. Supp. 586, succinctly states the rule:

> "Logic will permit no distinction in this regard between articles to be consumed by the human body internally and those to be absorbed by it externally. *The law should be no less solicitous of the outside of man that of his inside. On rea*son, cosmetics ought to be included with food in any rule or doctrine of law adopted for the protection of the health and safety of the public. Congress has done so in the Federal Food, Drug, and Cosmetic Act. (Italics ours.)
>
> To say there is no dependence of the buyer upon the retailer if the subject of the sale is a sealed product of another, is to ignore the most potent factor of every trader's success—the confidence

and reliance of the public in him. Further, the retailer is not a mere conduit or an automaton in delivering products of another; he owes an obligation to his buyer. He is paid for assuming that obligation. While he cannot know what is in the package, neither can the buyer, and it is the seller who has brought the injurious article to the buyer. *Moreover, the seller has recourse against the producer, and is generally better enabled to enforce such recoupment than is the consumer to obtain recovery of the manufacturer. Public policy requires that the buyer be allowed to seek reimbursement from the retailer.*" (Italics ours.)

CONCLUSION.

It is respectfully submitted that appellant has stated a claim upon which relief can be granted on breach of implied warranty because:

1. The parakeet was purchased by her for only one purpose, to-wit, consumption or use as a pet and, quoting from *Grisinger v. Hubbard* (Ida.), 122 Pac. 853,

> "*Where personal property ordered by a purchaser is only fit for one purpose and cannot be intended for any other purpose except the one for which they are ordered, as in the case of nursery stock (or a parakeet), the seller will be presumed to have sold them for that purpose and warranted them to be fit and proper therefor.*" (Italics ours.)

2. The animal cases are of doubtful value as authorities when the loss to the buyer is "property dam-

age'' as distinguished from ''personal injury'' to the buyer.

3. ''Scienter'' is unnecessary where the seller sells an article inherently dangerous such as a diseased bird. In speaking of inherently dangerous articles Justice Cardozo, in *MacPherson v. Buick Motor Co.* (N.Y.), 111 N.E. 1050, set out the law:

> ''If the nature of a thing is such that it is reasonably certain to place life and limb in peril when negligently made, it is then a thing of danger. Its nature gives warning of the consequences to be expected. If to the element of danger there is added knowledge that the thing will be used by persons other than the purchaser, and used without new tests, then, irrespective of contact, the manufacturer of this thing of danger is under a duty to make it carefully * * *''

4. The buyer has the right to presume that a bird sold in a Five and Ten Cent Store is free of contagious disease and that it is presumed that she bought it for a pet, relying upon the seller's skill or judgment that it was reasonably fit for the purpose for which it was intended.

Dated, Boise, Idaho,
May, 1956.

Respectfully submitted,
WALTER M. OROS,
Attorney for Appellant.

(Appendix Follows.)

Appendix.

Appendix

IDAHO CODE.

"Sec. 64-115. Implied warranties of quality.—Subject to the provisions of this law and of any statute in that behalf, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract to sell or a sale, except as follows:

1. Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required, and it appears that the buyer relies on the seller's skill or judgment (whether he be the grower or manufacturer or not), there is an implied warranty that the goods shall be reasonably fit for such purpose.

2. Where the goods are brought by description from a seller who deals in goods of that description (whether he be the grower or manufacturer or not), there is an implied warranty that the goods shall be of merchantable quality.

3. If the buyer has examined the goods, there is no implied warranty as regards defects which such examination ought to have revealed." * * *

"Sec. 64-309. Acceptance does not bar action for damages.—In the absence of express or implied agreement of the parties, acceptance of the goods by the buyer shall not discharge the seller from liability in damages or other legal remedy for breach of any promise or warranty in the contract to sell or the sale. But, if after acceptance of the goods, the buyer

fail to give notice to the seller of the breach of any promise or warranty within a reasonable time after the buyer knows, or ought to know such breach, the seller shall not be liable therefor."

"Sec. 64-507. Remedies for breach of warranty—1. Where there is a breach of warranty by the seller, the buyer may, at his election: * * *

b. Accept or keep the goods and maintain an action against the seller for damages for the breach of warranty. * * *

6. The measure of damages for breach of warranty is the loss directly and naturally resulting, in the ordinary course of events, from the breach of warranty." * * *

"Sec. 64-508. Remedies of buyer or seller—Interest and special damages.—Nothing in this law shall affect the right of the buyer or the seller to recover interest or special damages in any case where by law interest or special damages may be recoverable, or to recover money paid where the consideration for the payment of it has failed."

Title 64-101 et seq at page 603, Idaho Code states:

"Compiler's notes. This act was adopted in Idaho 1919, ch. 149, p. 443, effective January 1, 1920, and is here given as adopted, a few minor changes due to clerical errors having been made to conform to the uniform draft.

A prior law on the subject of sales is found in R. C., pp. 3324-3331, reen. C. L., pp. 3324-3331, which was repealed by the law herein contained."

No. 15071

IN THE

United States
Court of Appeals

For the Ninth Circuit

MAUREEN GARDNER,

Appellant,

vs.

J. J. NEWBERRY CO., INC.,

Appellee.

Appeal from the United States District Court for the District of Idaho

---

BRIEF OF THE APPELLEE

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SUBJECT INDEX

TABLE OF AUTHORITIES CITED

STATUTES AND TEXTS

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BRIEF OF THE APPELLEE

STATEMENT

Appellant's contention is that in reliance upon the skill or judgment of Appellee she purchased as a companion or pet from Appellee (Referred to by Appellant as a "Five and Ten cent store," Br. p. 32), a parakeet which had been offered to the general public; that the parakeet was infected with psittacosis and therefore was not fit for the particular purpose for which it was purchased.

Appellant then relies upon Section 15 (1) of the Uniform Sales Act (Section 64-115(1) Idaho Code)

which first declares the doctrine of caveat emptor and no implied warranties, excepting only in certain cases and specifically an implied warranty for the particular purpose for which goods are purchased where such particular purpose is made known to the seller and the buyer relies upon the seller's skill or judgment; Appellant further contending that such statutory provisions change the substantive law of Idaho as it previously existed.

Appellant does not state a claim to support such contention. No particular purpose such as breeding, trained animal, laboratory use or other special purpose is alleged. There is no allegation that Appellant relied upon the skill or judgment of seller. The allegation that Appellant relied upon an implied warranty does not bring Appellant within the statutory provisions relied upon, nor within the substantive law of Idaho; nor is such an allegation of reliance on an "implied warranty" any allegation of fact. Facts of particular use and reliance upon the skill or judgment of the seller, and that such reliance was made known to seller must first be alleged as jurisdictional to state a claim and such implied warranty.

Moreover, Section 15 of the Uniform Sales Act is merely declaratory of the English Common law which was the substantive law of Idaho prior to the enactment of the Uniform Sales Act and did not change such law. Section 73-116 Idaho Code specifically provides as follows:

> "Common law in force.—The common law of England, so far as it is not repugnant to, or

inconsistent with, the constitution or laws of the United States, in all cases not provided for in these compiled laws, is the rule of decision in all courts of this state."

Under the substantive law of Idaho there is no presumption of superior skill or reliance thereon or knowledge thereof under the circumstances above mentioned; and, clearly, no claim is stated by Appellant upon which any relief can be granted against Appellee.

The trial court, accordingly, sustained a motion to dismiss, and Appellant appeals therefrom.

SECTION 15, UNIFORM SALES ACT (SEC. 64-115 I.C.) IS MERELY DECLARATORY OF THE ENGLISH COMMON LAW

Williston on his work on sales, Vol. 1, p. 583, states that Section 15 of the Uniform Sales Act is clearly a codification of the English Common Law:

> "In regard to no other section of the Statute is it more important to remember that, except as clearly expressed otherwise, a codification of the common law is intended, though not of the previously existing unwritten law of any individual State enacting the Uniform Law. This particular section was taken nearly verbatim from the English Sale of Goods Act, except that it does not adopt the English terminology of 'condition' as distinguished from 'war-

> ranty.' And it has been said on high authority of the section in the English Act, 'The section completely incorporates the common law, and in no way limits its operation.' "

As noted by Mr. Williston, some states deviated from the English Common Law, and their local common law resulted in a somewhat different construction with reference to warranties; however, as heretofore mentioned, in Idaho by statutory provision the common law of England was made the rule of decision in all of our courts.

In many jurisdictions the courts have reiterated that this section is merely declaratory of the common law.

Child's Dining Hall Co. v. Swingler, 1938 197 A. 105, 173 Md. 490;

McNabb v. Central Kentucky Natural Gas Co., 1938, 113 S.W. 2d 470, 272 Ky. 112;

Hoback v. Coca Cola Bottling Works of Nashville, 1936, 98 S.W. 2d 113, 20 Tenn. App. 280;

The St. S. Angelo Toso, C.C.A. Pa. 1921, 271 F. 245;

Keenan v. Cherry, 1925, 131 A. 309, 47 R.I. 125;

Aetna Chemical Co. v. Spaulding, etc., Co., 1924, 126 A. 582, 98 Vt. 51;

Merrill v. Hodson, 1914, 91 A. 533, 88 Conn. 314, Ann. Cas. 1916D, 917, L.R.A. 1915B 481;

Matteson v. Lagace, 1914, 89 A. 713, 36 R.I. 233;

Sampson v. Frank F. Pels Co., 1922, 192 N.Y.S. 538, 199 App. Div 854;

G. B. Shearer Co. v. Kakoulis, 1913, 144 N.Y.S. 1077;

Ward v. Great Atlantic, etc., Tea Co., 1918, 120 N.E. 225, 231 Mass. 90, 5 A.L.R. 242;

Lieberman v. Sheffield-Farms-Slawson-Decker Co., 1921, 191 N.Y.S. 593, 117 Misc. 531;

Simon v. Graham Bakery, 111 A. 2d 884 (N.J. 1955);

Lee v. Cohrt, 232 N.W. 900 (S.D.).

New Jersey adopted the Uniform Sales Act in 1907. The New Jersey Court in 1955 in the case of *Simon v. Graham Bakery*, reported at 111 Atl. 2d 884, specifically held that the Uniform Sales Act provision relating to warranties merely declares and codifies the common law. The New Jersey Court in the case of *Misky v. Childs Company*, 135 Atl. 805, said:

> "The answering Appellant's second contention that the common law has been modified by the Sale of Goods Act, already referred to, we think it clear, not only from the foregoing but from the avowed scope and purpose of that Act, which, in respect to the question here involved, is but declaratory of the common law, that such contention cannot be sustained."

After quoting Section 15(1), the Court further states:

> "This is the language of the cases and was already the rule at common law."

Maryland enacted the Uniform Sales Act in 1910. Appellant's counsel refers to the Maryland case of *Vaccarino v. Cozzubo*, 31 Atl. 2d 316, decided in 1943. This case involved the sale of food for immediate consumption. The item purchased was pork sausage, and the plaintiff became ill with trichinosis. On page 318 of this opinion the Court, after quoting Section 15(1), said:

> "In the case of sale by a retailer for immediate consumption the sales act is declaratory of the common law holding that there is an implied warranty that the food is reasonably fit for the purpose."

The case was reversed for further proceedings to determine whether or not the food had been properly prepared, the Court holding that the warranty was not unlimited and would extend only to food to be eaten when properly cooked and that the seller was not an absolute insurer that the meat when eaten raw or cooked in an unusual or improper manner was wholesome. Counsel also cites the case of *Ward v. Great Atlantic Company*, reported in 1918, 120 N.E. 225.

Mass. had adopted the Uniform Sales Act in 1908. This case involved a pebble found in a can of beans.

The Massachusetts Court in referring to Section 15(1) on p. 226 of the report held:

> "That provision governs the relations of the parties in the case at bar. In this respect the statute is in substance so far as concerns a dealer such as defendant, simply a codification of the common law."

The Court made a distinction between the contents of a can sealed by the packer, and a purchase of goods which could be inspected:

> "The situation is quite different from the choice of a fowl or a piece of meat from a larger stock, all open to inspection, where there is opportunity for the exercise of an independent judgment by both buyer and seller, and where, therefore, the fact as to the one who makes the selection is of significance as in the Farrell case."

Michigan enacted the Uniform Sales Act in 1913. Counsel cites the 1934 case of *Cheli v. Cudahy*, 255 N.W. 414. In this case the plaintiff's wife died from trichinosis from eating uncooked sausage prepared from pork meat bought from a dealer who had been supplied by defendant packing company. After holding that the evidence disclosed no negligence on the part of the defendant in processing the pork, the court discussed whether the defendant could be held on the theory of implied warranty under subdivision (1) of Section 15 and concluded that it could not.

Referring to the language of subdivision (1), the Court said:

> "Tested by this language, the record does not disclose the buyer expressly or by implication made known to the seller that the pork was required for the purpose of making raw sausage to be eaten in an uncooked state, nor is there any showing that an implied warranty or condition as to the quality or fitness of raw pork as food in an uncooked condition is annexed to the sale by usage of the trade. See subdivision (5) of the same statute. Comparatively speaking only an infinitesmal amount of the pork sold is eaten raw. It seems to follow logically that it is unfair to impose the liability of insurer upon the meatpacker through the implication of a warranty that pork is fit for human consumption in a raw state."

In Lee v. Cohrt, 232 N.W. 900, at p. 903, the South Dakota Supreme Court said:

> "We t h i n k two warranties purporting to cover the same subject are bound to be inconsistent unless of the same legal effect. The Uniform Sales Act is not in conflict with the rule announced by the weight of authority prior to its adoption. It simply attempts to make the law uniform in states adopting the act and abolishes the minority rule prevailing in some states excluding all implied warranties where there is a written contract, or where there is an ex-

press warranty concerning any subject, though not the one involved."

In Griffin v. Runyon, 82 S.E. 686, West Va. 1914, page 688, the Court said:

"A mechanical article or instrument made of materials of known strength and duration and fabricated by known workmanship and methods is entirely different. So are vegetable products grown by the seller. These are all inanimate material things, the quality and characteristics of which are susceptible of accurate knowledge."

Barton v. Dowis 285 S.W. 988:

"The warranty in case of sales is collateral to the agreement of the sale. It is in the nature of a covenant against failure of the article for a certain specific purpose or for a certain specific reason. If a manufacturer warrants his machine to do good work of a certain character, that is no warranty that it will do good work of a different character. The implied warranty that the hogs purchased by Plaintiff were fit for breeding purposes was not a warranty that they would not communicate a disease to other hogs. A warrantor is bound only by the terms of his covenant. If the hogs were afflicted with disease which rendered them unfit for breeding purposes, then that Defendant, it may be con-

ceded, would be covered by the implied warranty. That warranty means that they were healthy and capable of procreation, that they would reproduce the kind and variety they were represented to be. There is no evidence to show that the hogs purchased by Plaintiff were not good for breeding purposes—the purpose for which they were bought."

"Where a stallion was purchased for breeding purposes, carrying an implied warranty, the contract did not include a warranty that he was free from a disease which would be transmitted to offspring. Citing cases."

"The implied warranty that the hogs were good for breeding could not, by any stretch, be construed as a covenant to hold Plaintiff harmless from any disease which the purchased hogs might have communicated to his other herd. That this would be covered only by the express warranty pleaded, which the Plaintiff appeared in submitting his case. Under the evidence, the only damage that could have occurred to Plaintiff by reason of the breach of warranty submitted, was the weakness and incapacity of one of the hogs, which Plaintiff claims became of no particular value, and was sold for small price. The judgment is reversed and the case remanded. All concur."

From an analysis of the foregoing cases it is clear that with respect to the matters involved herein the adoption of the Sales Act did not change the rule of

decision under the common law in effect in Idaho. The only effect that the adoption of the act could have upon any state would be to bring the law of those states into line with the generally accepted principles of common law insofar as the previous court decisions of a particular state may have differed from the cases under the English Sale of Goods Act and Common Law. This did not affect the Idaho rule for the reason that the Idaho rule was already in line with the language employed by the statute. Justice Vanderbilt in the Simons case supra, made reference to the scope and purpose of the Uniform Sales Act in showing that with respect to subdivision (1) there was no change in the common law.

As we have previously pointed out, Section 15 clearly states that the rule of caveat emptor shall apply, except in the situations enumerated in subdivision (1) with respect to implied warranty. The cases to which we have referred clearly show that the common law and under the common law as codified by the Sales Act, that there was an implied warranty with respect to food sold for immediate consumption, but that this was not an unlimited warranty, as shown by the cases cited by counsel. *Vaccarino v. Conzzubo*, 31 Atl. 2d 316; *Ward v. Great Atlantic Company*, 120 N.E. 225; *Cheli v. Cudahy*, 225 N.W. 414. These cases, all decided subsequent to the adoption of the Uniform Sales Act, arrive at the same result and employ the same reasoning as those under the common law decisions set forth by the Supreme Court of Idaho in the case of *McMaster*

v. Warner, 44 Ida. 544, 1927, 258 Pac. 547. As we have previously pointed out, the Idaho Court in the McMaster case stated that there is an implied warranty that such warranty is not absolute, but is based on an actual or presumed knowledge by the vendor of fitness of the thing sold for the particular purpose for which it was desired so far as such knowledge is reasonably attainable. We have previously shown that based upon this reasoning and upon public policy, the courts, long before the Sales Act crystalized the rule and the language shown in Section 15, had applied this presumption to sale of food stuffs for immediate consumption. Counsel cites many cases under both of these situations, but such cases are not analogous to the facts in the case at bar.

Not all jurisdictions have adopted the Uniform Sales Act, and those jurisdictions adopting the same did so at different times. Accordingly, in the citation of authorities note should be taken as to whether the decision involved was in a state that has adopted the Uniform Sales Act and whether rendered before or after such adoption and whether the English Common Law had been followed prior to such adoption.

There is no apparent unanimity in the decisions as to the existence of an implied warranty under Section 15 or under the common law, but a careful examination of the cases discloses they can be reconciled by having in mind that there grew up in the evolution of the common law certain instances where the courts were inclined to impute reliance, superior knowledge, skill or a particular purpose from the

facts. Although the word "presumption" is not often used and text writers contend that it is not a presumption, but a rational imputation of knowledge or skill superior in the seller, nevertheless, it can be more readily pointed out by referring to such tendency as a presumption in certain cases of a particular use as opposed to a general use, reliance upon the superior knowledge, skill and judgment of the seller and the knowledge of the seller of such reliance.

No useful purpose can be served by pointing out all of the instances where such presumption or tendency was indulged in by certain courts in favor of or against such imputation of skill and reliance, but for illustration purposes, we shall refer to a few outstanding instances.

In the case of a manufacturer who built the goods at common law, there was generally a presumed superior knowledge of skill of a vendor. *White v. Miller*, 71 N.Y. 118, 131, 27 Am. Rep. 13. This presumption was founded upon the premise that the person manufacturing an article knew what he was doing when he made it.

At common law the same tendency or presumption was indulged in with reference to the grower of seeds. *VanWyck v. Allen*, 68 B.T. 61, 25 A. Rep. 136.

In the case of a breeder of animals, the decisions holding the seller responsible have generally followed the same tendency, but have stressed the particular purpose which was obvious.

In the case of food for immediate consumption, at common law there was a strong tendency or pre-

sumption to hold the seller. In *Williston on Sales*, Vol. 1, p. 633, it is stated:

> "But whatever the basis of the doctrine it was laid down broadly by Blackstone, that 'in contracts for provisions it is always implied that they are wholesome, and if they be not, the same remedy (damages for deceit), may be had.' This statement is frequently repeated and relied on as a ground for decision."
>
> "It is doubtful, however, if it would now generally be held that there is such a warranty (in the absence of special facts showing reliance on the buyer's skill and judgment) unless the seller is a dealer, and importance is also attached to the fact that the buyer is buying for immediate consumption. In such a case the law is clear that a warranty is to be implied that the article sold is fit for human consumption."

It will be noted that the principles involved are not altered. In other words, as expressly provided in the Uniform Sales Act, there must be reliance upon the seller, knowledge in the seller of such reliance, and a special purpose. It is simply that in the evolution of the common law there grew up the imputation of these facts in the case of food for immediate consumption.

It is interesting to note that Appellant in several instances refers to the purchase of the parakeet for consumption as a pet (Br. pp. 2, 31). It maye be that Appellant is endeavoring to bring herself within the

rule with reference to food for immediate consumption. Manifestly, the rule has no applicability here.

As above noted, however, there is no unanimity today as to how far courts will go in such presumption, many states holding that the same allegations of reliance, knowledge and purpose must be made as in other instances. Complete analysis of all the cases and the split in the authorities is set out in Vol. 23, *Minn. Law Review*, pages 585 to 615.

Under the heading of Substantive Law of Idaho, we shall further discuss these various instances and show that the English Common Law was clearly followed by the Courts in Idaho.

At common law such imputation or presumptions were not indulged in where animals were involved. It was necessary to allege and show a particular, as opposed to general, purpose, reliance upon the superior knowledge, skill or judgment of the seller and his knowledge of such reliance.

The cases arising under Section 15(1), Uniform Sales Act and the English Common Law prior thereto, are legion. We shall merely call the Court's attention to some of the cases illustrating the principles involved, which reconcile substantially all of the cases.

To state a claim there must be an allegation of reliance upon Seller's skill or judgment, purchased for a particular purpose and knowledge thereof in the seller.

The St. S. Angelo Toso, C.C.A. Pa. 1921, 271 F. 245;

Dunbar Bros. Co. v. Consolidated Iron-Steel Mfg. Co., C.C.A. Conn. 1928, 23 F. 2d 416;
Keenan v. Cherry, 1925, 131 A. 309, 47 R.I. 125;
Aronowitz v. F. W. Woolworth Co., 1929, 236 N.Y.S. 133, 134 Misc. 272;
Whipple v. Sherman, 1923, 200 N.Y.S. 820, 121 Misc. 14;
Thomson v. Meyercord Co., 1919, 174 N.Y.S. 733;
Bonwit v. Kinlen, 1915, 150 N.Y.S. 966, 165 App. Div. 351;
Wasserstrom v. Cohen, 1915, 150 N.Y.S. 638, 165 App. Div. 171;
Standard Rice. Co. v. P. R. Warren Co., 1928, 159 N.E. 508, 262 Mass. 261;
Rinaldi v. Mohican Co., 1918, 121 N.E. 471, 225 N.Y. 70;
Rhodes v. Libby, 1930, 288 P. 207;
Santa Rosa-Vallejo Tanning Co. v. C. Kronauer, 1923, 228 Ill. App. 236;
Davenport Ladder Co. v. Edward Hines Lumber Co., C.C.A. Iowa 1930, 43 F. 2d 63;
Leiter v. Innis, 1912, 138 N.Y.S. 536;
Drumar Mining Co. v. Morris Ravine Mining Co., 1939, 92 P. 2d 424, 33 Cal. App. 2d 492.

As above noted, in the case of animals no presumption of knowledge, skill or reliance was indulged in

at common law, nor under the Uniform Sales Act. Appellant states that she has been unable to find any animal cases excepting the one case, which we shall discuss later, involving the sale of rabbits for immediate consumption where the injury complained of was in the handling of the animal; however, there are a number of cases illustrating the principle announced by the trial court. In other words, it had to be both alleged and proved that there was a special purpose, reliance upon the skill or judgment of the seller and knowledge in the seller. As an illustration, there was no implied warranty that heifers would be adapted to dairy and breeding purposes unless the buyer expressly or impliedly informed the seller that they were purchased for such purposes and relied upon the seller's skill or judgment. *King v. Gaver*, 176 Md. 76, 3 A. 2d 863, 1939. (Md. adopted the Uniform Sales Act June 1, 1910.)

An auction bill making no express statement that the cows offered for sale were sound or the equivalent, gives rise to no warranty of general condition or health. *Maeckel v. Diesenroth*, 1931, 253 Mich. 284, 235 N.W. 157. (Mich. adopted the Uniform Sales Act 1913.)

It is also elementary that where an animal is purchased for a particular purpose, there is no implied warranty for defect not covered thereby. Thus, in *Barton v. Dowis*, 315 Mo. 226, 285 S.W. 988, 51 A.L.R. 496, there was a sale of hogs under an implied warranty that the animals were fit for breeding purposes. The hogs died of the cholera, and the buyer

sued the vendor for damages. A judgment in plaintiff's favor was reversed, the court saying:

> "The implied warranty that the hogs purchased by plaintiff were fit for breeding purposes was not a warranty that they would not communicate a disease to other hogs.
>
> "Where a stallion was purchased for breeding purposes, carrying an implied warranty, the contract did not include a warranty that he was free from a disease which would be transmitted to an offspring.—Briggs v. Hunton, 87 Me. 145, 32 A. 794, 47 Am. St. Rep. 318. See also 24 R.C.L. 202; Johansmeyer v. Kearney, 37 Misc. Rep. 785 (76) N.Y.S. 930.
>
> "The implied warranty that the hogs were good for breeding could not by any stretch be construed as a covenant to hold the plaintiff harmless from any disease which the purchased hogs might have communicated to his other herd."
>
> Judgment affirmed.

It will be noted that in the cases cited by counsel there are a number of jurisdictions that have not adopted the Uniform Sales Act. Clearly the situation is different where, as Appellant states, "a warrant arising from representations made" as in the case of *Woolsey v. Zieglar (Okla.)* 123 P. 164, cited by Appellant. In the Iowa cases of *Peterson v. Dreher*, 194 N.W. 53 and *Trousdal v. Burkhart*, 224, N.W. 93, the principles heretofore discussed by us

were followed, because the buyer stated to the seller he desired to purchase the cow for breeding purposes. Again, the Minnesota case of *Alford v. Kruse*, 235 N.W. 903, cited by Appellant, follows within the breeder of animal cases. The other animal cases cited by Appellant are again in confirmation of the principles hertofore set forth where the purpose was communicated and reliance had upon the seller. Counsel appears to place great reliance upon the Illinois case of *Haut v. Kleene*, 50 N.E. 2d 855 (Ill. 1943). The Plaintiff contends that the Court in this case held that the implied warranty of fitness for human consumption would extend to a case where the damage occurred as a result of handling the diseased animal. Even a cursory reading of the case shows that the Court did not so hold. *Plaintiff's first quotation from the case is a discussion of what was contained in the Complaint and not the holding of the Court.* In the Haut case the retailer Slad had sold some rabbits for human consumption to the Plaintiff Haut. The Plaintiff's wife had an open cut on her hand at the time she was preparing the rabbits for cooking. The rabbits were prepared and eaten by the whole family with no ill effects. About a week later the Plaintiff's wife sickened and died, the doctor stating that it was his opinion that she had contracted tularemia or rabbit fever through the open cut in her hand and that such was the cause of her death. The Appellant Court reversed the cause ostensibly on the ground that the Court had erred in procedural matters in reversing rulings upon various motions of the separate defendants for directed

verdicts. In specific connection with the Plaintiff's claim and requested instruction that the implied warranty covered the handling as well as the consumption as food of the rabbits, the Court actually did not so hold and on page 857 said:

> "The case was submitted to the jury as shown by the instructions on the question of negligence as against the three defendants and on the question of implied warranty as against defendant, Amy Slad, and her counsel contend that the instruction on the implied warranty was improper and prejudicial. By it the jury were told that it is the law in this state that where a retailer sells articles of food for immediate consumption he is a 'warrantor that the articles he sells are wholesome and free from defects that may injure the health of the person for whom they are purchased' and if they find that Amy Slad sold the rabbits for immediate consumption that were 'diseased or infected with anything unwholesome, and which rendered it unwholesome as food and which could not be perceived by the plaintiff or his intestate and that by reason of such defect, Estelle Haut was made ill' and died as a result, and if the jury found she and her next of kin were in the exercise of ordinary care for her own safety, then the law required defendant to compensate plaintiff.
>
> "Counsel for defendant Slad contend this instruction was erroneous and unwarranted for

the reason that it is undisputed that the rabbits were cooked and eaten with no ill effects which showed they were good food and there was nothing in the instruction which referred to the question of the handling of the rabbits as plaintiff had alleged in his amended complaint. *In view of the state of the record, which we have above set forth, we think the instruction might tend to confuse the jury. But in any event, we are of opinion that the issue can be submitted as against the defendant Amy Slad without any confusion.*

"Counsel for defendant Slad say that the decided weight of authority in the United States holds that there is an implied warranty that m e a t s sold for immediate consumption are wholesome and that this implied warranty cannot be extended to the handling and preparation of meats."

The Illinois Court, having reversed the case on the procedural matter, then went on to hold that any implied warranty as to fitness for human consumption would extend to the Plaintiff's wife rather than having failed because of lack of privity of contract between the purchaser of the food and the injured person. But as clearly shown by the foregoing quotation, the court did not hold that implied warranty for fitness for human consumption covered injury sustained by means other than actual consumption of the animals as food. And in fact, the evidence of

the case clearly showed that the injury was not the result of consumption as food.

Further, the evidence in the Haut case showed that the Defendant, Mrs. Slad, had made an express warranty that the rabbits were good fresh rabbits. The report on page 856 of said opinion states: "He testified that he asked Mrs. Slad if they were good fresh rabbits and she said they were."

It follows that this case can be cited only for the proposition that in Illinois, the court cannot under the conditions set forth, reserve rulings on a motion for directed verdict and that an implied warranty of fitness for human consumption of food stuffs extends to the family of the purchaser. Neither of these matters is an issue under the pleadings in this case.

Appellant stresses the circumstances of the sale. This, of course, was the basis of the tendency or imputation or presumption raised at common law in certain instances, as hereinbefore discussed. Animals were never included in such instances; however, there is no allegation of fact in this case setting forth any special circumstances. As a matter of fact, the bare allegations negative the requirements of the statute.

In *Miller Lumber Co. v. Holden*, 1954, 273 P. 2d 786 (Wash.) (adopted Uniform Sales Act 1926) where there was a sale of rough Alder lumber, and both parties were unfamiliar with Alder lumber, there was no implied warranty.

Another illustration is *Wasserstrom v. Cohn*, 150 N.Y.S. 638 (adopted Uniform Sales Act 1911) where a reliance was declared to have been had on the skill and knowledge of the plaintiff's salesman, the court held that as between the salesman and the purchaser, the parties stood in at least an equal position.

In *Lindsey v. Stalder*, 208 P. 2d (Colo.) 83 (adopted U.S.A. 1942), where a certain type of wood was ordered and the buyer knew that the seller had no particular experience in such wood, there was no presumption of any superior skill or knowledge.

Probably the best illustration of so-called circumstances with reference to the raising of a presumption or imputation of reliance and particular purpose, is the case of Torpey v. Red Owl Stores (Minn.), 1955, 129 F. Supp. 404 (Minn. adopted Uniform Sales Act 1917). In the light of the historical decisions at common law with reference to food for immediate consumption, the case is interesting as to the circumstances from which reliance and knowledge of purpose may be imputed. In other words, conditions have changed. In the super market and other institutions carrying on business in a similar manner the salesman or saleswoman handles the goods. The super market or the five and dime stores are retailers. There must be some rational basis for any presumption. The Court said:

> "This question of reliance is raised, of course, whenever one seeks to hold liable a mere retail dealer for injuries caused by latent defects in

an article which the dealer cannot reasonably be expected to discover. *It has very persuasively been argued that the reliance necessary to a finding of an implied warranty is not reasonably found in such a situation, and that the retailer in such circumstances should not be responsible.* See Waite, Retail Responsibility—A reply, 23 Minn. L. Rev. 612 (1939). Accordingly, numerous courts have held that the warranty does not apply to retail dealers as to latent defects. E. g., Scruggins v. Jones, 1925, 207 Ky. 636, 269 S.W. 743; Kroger Grocery Co. v. Lewelling, 1933, 165 Miss. 71, 145 So. 726; Aronowitz v. F. W. Woolworth Co., 1929, 134 Misc. 272, 236 N.Y.S. 133; United States Fidelity & Guaranty Co. v. Western Iron Stores Co., 1928, 196 Wis. 339, 220 N.W. 192, 59 A.L.R. 1232; See Prosser, Torts 671 and cases cited n. 32. Indeed, in what sense can the consumer be said to rely upon the retail dealer as to the freedom from hidden defects of the many products he sells? *No reasonable person today assumes that the supermarket operator knows anything more about the hidden contents of goods in sealed containers than the consumer knows himself. Surely he does not believe that the operator could do more than make a cursory inspection of the article. Certainly the purchaser in the case at bar did not expect the defendant to make a microscopic examination of the walls of the jar to determine their resist-*

ance to stress. If she relied upon the judgment of the defendant at all, she could not have relied to a greater extent than to expect him to choose reputable suppliers, and to offer goods which a reasonable inspection showed to be safe.

"It seems to be conceded even by the proponents of a theory of strict liability upon retail dealers that 'only by some violent pounding and twisting' can the requisite reliance be found in cases like the present. See Prosser, Torts 692 (1941); Brown, The Liability of Retail Dealers for Defective Food Products, 23 Minn. L. Rev. 585 (1939). Nevertheless it is argued that 'public policy' demands the imposition of strict liability. However, the cases previously cited register disagreement with such an interpretation of the public policy, and for reasons to be set out subsequently, this court is not disposed to engage in the necessary pounding and twisting."

SUBSTANTIVE LAW OF IDAHO UNCHANGED BY UNIFORM SALES ACT, SEC. 15 (SEC. 64-115 IDAHO CODE)

As heretofore noted, caveat emptor was the rule at English Common Law with certain exceptions. This rule, together with the exceptions, was codified by Section 15 of the Uniform Sales Act, which expressly provided that there was no implied warranty or condition as to quality or fitness for any particular purpose, excepting as specifically provided in

this section. As heretofore pointed out, the English Common Law was by statute made the rule of decision in Idaho. The substantive law of Idaho, therefore, was unchanged and such rule was codified by Section 15.

Appellant complains that the trial court overlooked the paragraph following the reference to American Jurisprudence, which paragraph specifically states that there is an implied warranty where the seller knows that the animal is being bought for a particular purpose and relies upon the seller's skill or judgment that the animal is fit for that purpose. It was proper for the court not to refer to this paragraph because it is not involved in any of the issues of this case. Appellant did not allege that he relied upon the skill or judgment of the seller, that he was purchasing the parakeet for any particular purpose, or that the seller had knowledge of such reliance or sale for such purpose. There is no allegation that the sale was by description, sample or any particular purpose as opposed to a general purpose. It will be noted that in all of the animal cases whether at common law or under the Uniform Sales Act, there must be a special purpose and reliance upon the skill or judgment of the seller as to such purpose. In these cases the particular purpose was either for breeding or some other special purpose.

As illustrated by the auction case, *Maeckel v. Diesenroth*, 1931, 253 Mich. 284, 235 N.W. 157, supra, the auction bill made no statement that the cows were sound or the equivalent.

The Court said:

> "As there was no express statement in the bill that the cows were sound or the equivalent, there was no warranty of general condition or health. 24 R.C.L. 202; 35 Cyc. p. 388; Puls v. Hornbeck, 240 Okl. 288, 103 P. 665, 138 Am. St. Rep. 883, 29 L.R.A. (N.S.) 202."

However, the auction bill did state the stage of milk production of some of the cows, and the Court then said:

> "In offering them for such particular purpose, the seller was impliedly charged with notice that a purchaser, who should rely upon the offer and declare no other specific object, would buy them for use as milk cows, so the sale carried the implied warranty that they were reasonably fit for that purpose."

We should call the Court's attention to the fact that that case was decided in 1931, and that Michigan had adopted the Uniform Sales Act in 1913. Whether in the sale of a cow or a parakeet, in the absence of knowledge of the seller of a particular purpose, the exception in Sec. 15 does not apply. The ordinary use of a parakeet is simply in a cage or, as alleged by Appellant, as a pet. A particular use would be for the purpose of breeding, trained animal act, laboratory use, or other special purpose. As pointed out in the illustrated cases heretofore cited a "five and dime store" either is neither a breeder

of birds, nor the occupation so special as to create imputation of superior skill or judgment, as in the special instances heretofore cited.

The Supreme Court of Idaho has always followed the rule of decision of the English Common Law. We shall illustrate briefly by the cases so decided that Section 15 (Section 64-115(1), Idaho Code), merely codify such law.

In the case of *McMaster v. Warner*, 44 Ida. 544, 1927, 258 Pac. 547, the heifer involved was infected with germs of a disease called actinomycosis. These germs set up an infection known as the ray fungus and is communicable. The disease sets up an abrasion known as lump jaw. The Court held there was no implied warranty. The Court quoted with approval the following quotation:

> "The rule (of implied warranty) must be held to have a rational foundation, and to be not of a purely arbitrary character."

Appellant (Br. p. 12) argues that the animal did not develop the defect until many months after the purchase. The fact is, it was not visible until the lump appeared. On the other hand, the parakeet was not discovered to have had psittacosis until many months after purchase. Appellant likewise argues that the heifer was purchased upon personal inspection by the buyer. That is also true in the case at bar, neither could the psittacosis nor the actinomycosis be discovered by such inspection by either party. Appellant further argues that the heifer was not to

sold to be used by human consumption. That is also true in the case at bar with the parakeet.

Appellant argues that the statements in the case are dicta. Under the facts of the case, the statements are certainly not dicta, but even if they were, they would be *considered dicta* under the rule well stated in the case of *Yoder v. Nu-Enamel Corporation*, 117 F. 2d 488. The Court of Appeals, 8th Circuit, declared that:

> "In the application of a state statute, the federal courts are, of course, bound by the construction made by the courts of the State. Senn v. Tile Layers Union, 301 U.S. 468, 57 S. Ct. 857, 81 L. Ed. 1229. And the obligation to accept local interpretation extends not merely to definitive decisions, *but to considered dicta as well.* Hawks v. Hamill, 288 U.S. 52, 53 S. Ct. 240, 77 L. Ed. 610; Badger v. Hoidale, 8 Cir., 88 F. 2d 208, 109 A.L.R. 798. Indeed, under the implications of Erie Railroad Co. v. Tompkins, 304 U.S. 64, 58 S. Ct. 817, 82 L. Ed. 1188, 114 A.L.R. 1487, and West v. American Telephone and Telegraph Co., 61 S. Ct. 179, 85 L. Ed. . . , where direct expression by an authorized state tribunal is lacking, it is the duty of the federal court, in dealing with matters of either common law or statute, to have regard for any persuasive data that is available, such as compelling inferences or logical implications from other related adjudications and considered pronouncements. *The responsibility of the fed-*

eral courts, in matters of local law, is not to formulate the legal mind of the state, but merely to ascertain and apply it. Any convincing manifestation of local law, having a clear root in judicial conscience and responsibility, whether resting in direct expression or obvious implication and inference, should accordingly be given appropriate heed.

"But the answer to the question is to be resolved, not by logical impulse or from outside authority, if there exist any convincing, indicative utterances on the part of the Supreme Court of (the state) . . ." (Emphasis added.)

Appellant then argues that the rule was modified in the case of *Koser v. Hornbeck*, 75 Ida. 24, 265 P. 2d 988. This is a case where a horse was hired and the rider injured. It was a case of bailment and not sale; however, the Court used the word implied warranty, but the Court expressly held that thereunder "*the plaintiff must prove that the keeper had some knowledge, or the facts are such as to charge him with knowledge, of the unsuitability of the animal."

In the case of Grisinger v. Hubbard, 21 Ida. 469, 122 Pac. 853, 1912, there was involved one of the exceptions hertofore mentioned at common law of a nurseryman selling trees for orchard purposes. The court followed the common law rule of a particular purpose and reliance upon the seller's skill or judgment and indulged in a presumption because of the nature of the business. The Court said:

"There can be no question, we think, but that a nurseryman growing young fruit trees for the purpose of sale to persons desiring to cultivate a commercial fruit orchard with a view of raising fruit for commercial purposes, is presumed to have produced such young fruit trees for the purpose of developing into commercial trees; that is, trees that will produce fruit suitable for commercial purposes, and that in selling such trees for that purpose the nurseryman intends that they shall be suitable and adapted to the purpose for which they are sold and of the kind and quality which fulfills the purpose for which they were originally produced; * * *"

Again, for illustration, the case of Barnett v. Hagen, 18 Ida. 104, 108 Pac. 743, 1910, involved the purchase of a burglar proof and fire proof safe. Here again there was a particular purpose made known to the seller and reliance upon the seller's skill or judgment. The Court said:

"By the contract the defendants agreed to purchase a No. 8 F. & B. Victor safe, and the plaintiff in describing such safe told the defendants that it was a burglar and fire proof safe. This amounted to an implied warranty that the safe purchased was a fire and burglar proof safe as such term is usually applied, and that the safe was suitable for the purpose for which it was purchased. (Hunter v. Porter, 10 Ida. 72, 77 Pac. 434; Huntington v. Lombard, 22 Wash.

> 202 60 Pac. 414; Lander v. Sheehan, 32 Mont. 25, 79 Pac. 408; 13 Am. & Eng. Ency. of Law, 135; Benjamin on Sales, Sec. 661; Kellogg Bridge Co. v. Hamilton, 110 U.S. 108, 3 Sup. Ct. 537, 28 L. Ed. 86.)"

Another case that involved the purchase of seed, one of the illustrations that we used in connection with the common law, was *Tomita v. Johnson*, 49 Ida. 643, 290 Pac. 395. This Court said:

> "Where one desiring seed makes known to a dealer his needs for planting, and a selection of seed is made upon recommendation by the seller, there arises an implied warranty that the seed is suitable for the purposes intended. Wapato Fruit & Cold Storage Co. v. Denham, 126 Wash. 676, 219, Pac. 30."

Counsel makes reference to confusion existing in the Idaho law under implied warranties. Our research fails to reveal any confusion. As shown by the foregoing Idaho cases, there is no confusion existing with respect to implied warranties in the holdings of the Idaho Court, either before or after Idaho's adoption of the Uniform Sales Act, and as previously pointed out, the Idaho Supreme Court in the McMaster case had already established the rule adopted by the language of Section 15(1) of the Sales Act herein. We believe this to be an analogous situation to that found in the Idaho case of *Sanger v. Luken*, 26 Fed. 2d 855. The Federal Court there had under

consideration an Idaho statute which had been amended, and in holding that the former Idaho decisions bound the Court, said in its opinion:

> "Under familiar principles we are bound by this construction of the Act of 1925, and admittedly the amendatory Act of 1927, contains no language enlarging its scope."

In the case under consideration, the Federal Court in determining what the Idaho law herein is is bound by the reasoning of the McMaster case since admittedly the Uniform Sales Act does not enlarge the scope or change the language of the rule laid down by the Idaho Court in that case.

We find these cases as illustrative of the fact that the Supreme Court of Idaho has followed the statutory requirement that the English Common Law is the rule of decision in Idaho. The principles involved are identical with those codified by Section 15. As a matter of fact, although the sale in the case of McMaster v. Warner, supra, was made some months before the effective date of the Uniform Sales Act in Idaho, the case was not decided until some seven years later. Accordingly, the substantive law of Idaho has at all times been and now is as codified by the Uniform Sales Act.

APPELLANT STATES NO CLAIM AGAINST APPELLEE UPON WHICH ANY RELIEF CAN BE GRANTED

As heretofore noted, under the substantive law of Idaho the rule of caveat emptor applies unless a claimant brings himself under certain exceptions, which rule was codified by Section 15 Uniform Sales Act (Sec. 64-115 I.C.) by first stating that no implied warranties exist excepting in certain instances which are identical to those at the English Common Law; and that the state of Idaho specifically provided by statute that the English Common Law is the rule of decision in Idaho. Appellant in her brief contends that she comes within the exception of the rule of caveat emptor in that she purchased a parakeet for a specific purpose, made known such purpose to the seller, and that she relied upon the skill and judgment of the seller, however, the complaint raises no such issue. It was, therefore, not necessary for the Court to discuss such exception to the general rule of caveat emptor.

There is no allegation of any purchase for a particular or specific purpose as opposed to a general purpose. There is no allegation that Appellant relied upon the skill or judgment of seller or that seller knew of such reliance. Appellant apparently endeavors to rely upon some presumption of knowledge, particular purpose and reliance; hence the reference to food cases—food for immediate human consumption, even to the point of stating that the

use of an animal in the ordinary way was "consumption."

As heretofore pointed out, the tendency to impute or presume facts in certain instances at common law were not only restricted to cases such as manufacturers, breeders and food, but no such imputation or presumption was ever indulged in insofar as animals were concerned—nor has Appellant found any such case. In the cases we have cited and in all of the texts, the general rule of caveat emptor applies in the case of animals, and only where there was a specific or particular purpose, the seller is a breeder and specially in the business for a certain purpose, would the Court find knowledge or reliance under proper allegations.

It will also be noted in the cases hereinbefore mentioned that the particular purpose in the statute, as well as at the English Comon Law, must be a specific purpose. Manifestly, the ordinary use would not be a specific purpose. In the purchase of a bird the ordinary or general use would be to have the bird about the house in a cage of other enclosure. This is referred to by Appellant as a companion or pet (Br. p. 2, 31). An analogous case would be the purchase of a dog. The general purpose would be to have him near the house in a dog house or in the house generally, again as a companion or pet. Courts, however, have held that the specific purpose would be that of a breeder or trainer where the dog was purchased for either breeding purpose, hunting or other special purpose. So, likewise, as pointed out in the case of a cow, unless it was purchased for

breeding, milking or other special purpose, there was no implied warranty.

The only fact alleged is that Appellant purchased a parakeet from Newberrys, referred to by Appellant as a "five and ten cent store" (Br. p. 31), which had been offered to the general public. There is no allegation and could not be any allegation that Newberry was in the bird business or was the breeder of birds, or was selling the same for any special purpose, such as breeding, talking birds, trained animals, laboratory use, or any of the many special purposes for which a parakeet could be used. As was stated in the case of *Torpey v. Red Owl Stores, supra,* no reasonable person today could assume that in a five and ten cent store the clerk would know anything more about hidden defects than the purchaser himself. Surely the sales person could make no more of an inspection than the purchaser. As said in the case above mentioned, certainly the purchaser could not expect the sales person to make a microscopic examination. Neither in the case of the lump jaw, *McMaster v. Warner, supra,* where there was alleged that germs existed at the time of the sale nor in the case of the parakeet here involved where it is contended that psittacosis or parrot fever germs existed at the time of the sale, was such existence discovered until several months later, and the same could not have been discovered at the time of the sale, excepting by microscopic, pathological laboratory tests.

There is no allegation that the parakeet, at any time, exhibited any evidence of diseased condition

or did not get well. There is no allegation that Newberrys was a pet store or a breeder of birds. In fact, the allegations negative such facts by merely alleging that the so-called five and ten cent store offered parakeets to the public generally at its store. There is no allegation bringing Appellant within the exceptions to the rule of caveat emptor, either at common law or under the Uniform Sales Act by imputation from facts, such as the seller being a nurseryman, a seller of seeds, a grower, specialty business, manufacturer, or other illustrations heretofore noted. In fact, there is not even an allegation of fact of reliance upon the seller's skill or judgment.

Appellant's statement in her brief that the parakeet was for "consumption" apparently is an effort to bring her within one of the special presumptions or imputations of knowledge and reliance as in the case of food for immediate consumption, which certainly is negatived by the allegation of consumption as a pet; however, as hereinbefore pointed out, even in the food cases the imputation or presumption of knowledge and reliance upon skill or judgment has been discarded by many jurisdictions, including those adopting the Uniform Sales Act because of no rational basis under present conditions where purchases are made at supermarkets, five and ten cent stores and similar businesses. As said by Williston on his work on Sales, Vol. 1, p. 610, "His (seller) occupation is, however, important evidence of the justifiableness of the buyer's reliance." In other words, this is the basis of the imputation or presumptions indulged in in certain instances at common law

in cases such as manufacturer, breeder, nurseryman, etc. As heretofore pointed out, Appellant makes no allegation of reliance upon seller's superior skill, knowledge or judgment, but merely that Appellant relied upon an implied warranty, which is not an allegation of fact, nor an allegation of the facts required to bring Appellant within the exception of reliance upon the skill or judgment of seller. Moreover, Appellant could make no such allegation, and if she did, she could not prove it because it would be unreasonable to assume that a sales person in a five and ten cent store could have any knowledge or would have any superior skill or judgment. There being neither allegation nor any rational basis to bring Appellant under the exception, Appellant clearly came within the rule of caveat emptor, and the order of the trial Court should be sustained.

Respectfully submitted,

J. L. Eberle
Dale O. Morgan
T. H. Eberle
W. D. Eberle

No. 15,072

United States Court of Appeals

For the Ninth Circuit

PEGGY LOU RIKER and FREDA H. GRASSMEE,

Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

BRIEF FOR APPELLANTS.

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No. 15,072

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PEGGY LOU RIKER and FREDA H. GRASSMEE,
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BRIEF FOR APPELLANTS.

This is an appeal from a decision of the United States Tax Court in the consolidated cases of Freda H. Grassmee, and Peggy Lou Riker, under 26 U.S.C.A. 7482.

The defendant, Freda H. Grassmee, was employed during the taxable year of 1948 and 1949, receiving a salary from her employment (R. p. 140). She donated her entire income to her Church, using the Church form #399 in evidence (R. p. 140), that the money was to be used exclusively for religious purposes of the Church. Notwithstanding the wages withheld, the Commissioner determined a deficiency against the taxpayer for $176.53. The petition to this deficiency was

filed with the United States Tax Court, seeking a redetermination, contending that 15% of the income was permitted as a deduction under Section 23(o), Internal Revenue Code, her entire wages having been given to the Church for religious purposes.

On September 1954, two months prior to the Tax Court Trial, the Commissioner filed an amended answer setting forth that Mrs. Grassmee on her return for the taxable year 1948-1949 claimed two (2) exemptions, one for herself and one for her mother, and contended that because Mrs. Grassmee's mother lived with her in the apostolic group of the Church, the petitioner was not entitled to take an exemption for her mother. The mother was eighty-four or eighty-five years old, (R. p. 141), and the mother lived with the taxpayer when she joined the Church, and the taxpayer was then supporting her (R. p. 141). During the entire years of 1948 and 1949, the mother lived with the taxpayer, and moved with her from the Church group in Los Angeles to the Church group in San Francisco. Both the taxpayer and her mother lived as a part of the apostolic society, and were supported by the Church during both these years.

The appellant, Peggy Lou Riker, with her husband had been in partnership in a drug store with his parents. The partnership was dissolved, and the taxpayer and her husband took the fixtures from the business and made a cash settlement with the parents and joined a group with the Church in San Bernardino. The group worked together to set up the project of the Church (R. p. 144). During the years involved from

September 1947 to January 1948 all of the gross receipts from that group in the Church project known as "Your Foods Fountain" was turned over to the Elected Delegates Committee of that Church (R. p. 145). The entire gross receipts of that Church group were transmitted with the Church form #399 which stated that the money was transmitted to be used by the Elected Delegates Committee of the Ecclesiastical Society of Christ Church of the Golden Rule for religious purposes of the Church.

The taxpayer was known as the "project manager" of the Church group (R. p. 145), which involved duties of instruction and teaching others in their ecclesiastical works and studies (R. p. 146); Canon Law #22 (R. p. 53). Materials and supplies were purchased from the project bank account, and the group were reimbursed through the Elected Delegates Committee (R. p. 147). All bills and receipts of expenditures were required to be submitted to the Committee and the group were reimbursed to that extent (R. p. 147).

The taxpayer lived with a group on a ranch a short distance from San Bernardino (R. p. 150). The group at San Bernardino were part of the larger apostolic society living group of the Church (R. p. 155). The group lived from revolving funds provided by the Elected Delegates Committee (R. p. 117). The student minister training project at San Bernardino was maintained by the Church for the purpose of making it possible for the student ministers to express and live in their daily activity, the teachings of the Church (R. p. 115).

The Church has congregations and its teachings (see declaration of faith R. pp. 20-22, tenet, R. p. 30, purpose, R. pp. 31-32, duties, R. p. 55), which include the concept that mere talking about Christ's teachings is not sufficient, but it should be seriously lived by men (R. pp. 110-111), and the teachings of the Church include that Christ's teachings should be lived and applied to everyday activity; that giving does not impoverish nor does withholding enrich and most of this world's ills are suffered from selfishness and greed and desire to get something for oneself rather than to give all one has to glorify the Creator. Giving with no thought of return brings back to the giver all that he needs. Those in the Church study and practice this everyday application of Christ's teachings regardless of what they did. The ministry of the Church is the bringing to the public so that they can see how it actually works and the Church has Student Minister Training Projects to let the public witness the daily application of Christ's teachings in whatever the group happens to be doing (R. pp. 110-113).

The Church's ministry is to bring to the world, a way that they would be able to see how it works. The Church has a cross-section of projects for this purpose to promulgate and spread the teachings of the Church (R. p. 113). Some of the Church members live at home and these congregations are similar to other Churches. Others take the Church's teachings as their life's work, and live in the Apostolic Society and study and learn to live this way of life to be teachers and way-showers as was Jesus Christ (R. p. 114).

The various living groups of the Apostolic Society of the Church are Student Minister Training Projects (R. p. 114), which were selected by the Church primarily for the purpose of more widely dispersing and promulgating these teachings by having the public come in contact with the student ministers in training (R. p. 116), and to train the students to spread these teachings to the public (R. p. 119). Some are run at a financial loss (R. p. 120), the sole consideration for maintaining or continuing a project was whether or not it was serving the purpose of promulgating the Church's teachings and its ministry (R. p. 120). They have ordinary theological work in the ministry training and the laboratory work, where they take the teachings and interpret and apply them into whatever walk of life or activity they may be asked to serve (R. pp. 120-121).

The Elected Delegates Committee is a temporal agency of the Church for operating and handling the property of the ecclesiastical government, after the ecclesiastical government has designated what it shall be used for and where. The ecclesiastical government, not the Committee, makes these determinations. The ecclesiastical government determines who are members and how much the Committee shall provide or pay to support any group, and the Committee is responsible to carry them out (R. p. 125), (Canon Law #12, R. pp. 41-44).

Where one project makes more money from the application of Student Minister activities and gifts, that group does not live better than another project

(R. p. 126). The entire Apostolic Society has a single budget for living costs set by the ecclesiastical government (Canon Law #12, R. pp. 41-44), and all are treated equally (R. p. 126). All of the funds come into the main Treasury and living expenses are paid by the Committee according to the budget set (R. p. 126). When there is a profitable period, it does not mean a better living standard for those in the Apostolic Society as that is not in the purpose of the ministry (R. p. 127). When there is a deficit, the deficit to meet the budget for living comes from sale of property the Church owns for its religious purposes (R. p. 126).

All of the earnings of the various groups as a by-product of the Student Minister Training and the Church activities went to the Church (R. p. 137), together with gifts and donations of individuals. Each project had its own revolving fund and its own living budget set by the ecclesiastical government (R. p. 137), and all groups had the same living standard, so that if one lived on a ranch such as that near San Bernardino, and raised their own food, that was taken into consideration (R. p. 137). During 1948 and 1949, the Committee of the Church filed its informational return, Form 990 as an exempt organization should (Exhibits 2 and 4), and a Form 1065 return listing the names of each member (a total of 575 in 1948, and 605 in 1949), (Exhibits 3 and 5), and the individual members during each of the years filed by family group listing the pro-rata share as a dividend in strict conformity with Rev. Code Sec. 101, Subdivision 18, applicable to Apostolic Religious Societies. Examples appear in the record as Riker returns (Exhibits 6 and

7), and Grassmee returns (Exhibits 11 and 12). Each shows the number in the taxpayer's family and (for example 1948) 1/575 interest in $217,001.54 net income of Elected Delegates Committee, as not received as a dividend but reported under Section 101(18) per person in Association, $377.39; 2 persons, $754.78. The taxpayer stated in each return by a sheet attached the amount contributed to the Church, and since all contributions were included and reported as part of the Apostolic Society income, taxpayer would be taxed twice on the same income by reporting it as wages and also as a dividend, for this reason only the dividend or pro-rata share of the Apostolic Society was reported (R. pp. 86-87 and Exhibits 6, 7, 11 and 12).

At the Church project at San Bernardino, between 12 and 17 lived on the ranch as part of the Apostolic Society (R. p. 146), and they conducted the Student Minister Training Project of Your Foods Fountain (R. p. 146). The old church corporation having fallen into the hands of the Bankruptcy Court, the trustees in bankruptcy collected the Church's gifts and services of its members after the adjudication. The Judge ordered the trustees in bankruptcy to cease operating the Church and these trustees claimed the property used by these members (R. p. 128). Out of this grew the agreement, set forth by the Petition and Order of May 1947 (Exhibit 9), and finalized by the Petition for Approval and Confirmation of Sale of Personal Property in July 1948 (Exhibit 10).

By that series of negotiations and agreements between the Trustees in Bankruptcy and the Church

Committee, the Committee made a note for $1500 to buy the property and subsequently paid the note (R. pp. 129-130). The Elected Delegates Committee finally sold the property of that project in 1949 and the Committee received the proceeds of sale (R. pp. 130, 148).

Because of this difficulty and it was no longer suitable for a Church project, the activity was closed as a Church project in January 1948. Mrs. Riker operated the fountain as a partnership, changing partners from time to time while the Committee tried to sell the business (R. p. 129), and for the most part her partners were relatives (R. p. 149), until the final partnership was an intended purchaser (R. p. 151). During the partnerships it was run as a private business (R. p. 150), but Mrs. Riker gave all her share of partnership income to the Church. This delay from January 1948 to July 1949 arose because of the cloud and defects in the title to the equipment (R. p. 151 and 156), and not until early 1949 was the sale affected (R. p. 152).

It should be noted Mrs. Riker's taxable year ran from September 1947 to September 1948 and that she showed in her return all the receipts of that Church project and showed she operated it but claimed she was taxable only on her proportional share of the Apostolic Society's income, (including donations and not deducting costs of living designated "Student Minister Maintenance").

Although the gross receipts were delivered by her as head of the San Bernardino group to the Elected Delegates Committee on gift forms #399, the Committee

reimbursed the revolving funds for all operating expenses of the project. The Committee purchased the Trustee in Bankruptcy's claim to the fixtures, etc. of the project "Your Foods Fountain". Mrs. Riker was but one of a dozen whose efforts went into the activity. The net income is thus the sum total of those separate items, if we view it as a taxable business:

(1) Use and exhaustion of the capital such as fixtures, equipment and money to operate furnished and owned by the Elected Delegates Committee.

(2) Labor of some 12 to 17 persons, all part of the Apostolic group who worked in this project as part of their religious work, intending any by-products of their labors to go to their Church as it did, for advancement of their religious crusade.

(3) Wages of management which was the product of Mrs. Riker's efforts, which she intended to donate and for it to go to her religious crusade as it did.

After it was no longer a project there were still elements of income of any business.

(1) Return and risk of the investment and exhaustion and depletion of physical property.

(2) Personal services of those working in the food fountain.

The partnership returns show very small volume of business and that the partners divided all the income without allotting or paying any part for the use of the investment or depletion of the physical assets owned by the Church Committee. Mrs. Riker gave all she received from these partnerships to the

Church Committee, as well as the product of her labor and there was no segregation intended or attempted as all went to the Church for its religious purposes.

The Riker return contained an error whereby she over-reported actual gross receipts and therefore net of the food fountain operation by $969.26 (R. pp. 155-158), all of the gross receipts being deposited to the account of the Elected Delegates Committee, and while it was operated as a Church project demonstrating Christ's teachings (R. pp. 155-156) and operated through the efforts of a dozen student ministers on that project as a ministry of their religion (R. p. 156). The net income of the business as shown in the return had a $2,000.00 omission of materials and supplies after the project was closed and prior to the sale by the Committee being effected. This testimony was not controverted and the Commissioner did not claim to have audited the accounts or record and he made his determination of deficiency on the basis of the contention that the income of the project, including the return and risk on the investment of the Committee—exhaustion of assets owned by another, efforts and labor to produce this income by those in the ministry who were not paid or compensated by the taxpayer were taxable to Mrs. Riker alone as an individual and she could not deduct anything as a donation to her Church.

CHURCH ORGANIZATION.

Christ's Church of the Golden Rule was organized along the conventional lines. It had an organic law which it called a Church Constitution and Canon Laws (Exhibit 1 in evidence, appearing in the record, pages 20 to 67). Ecclesiastical matters are vested in the ecclesiastical head, the Senior Elder, and the Board of Elders, a legislative body, and the College of Pastors. Final ultimate control vested in the Convention that had full power to remove any official and make any final act. It could be called by either the Senior Elder or by 25% of the Church members and convention members are elected by the membership.

Property and income of the Church are held by Temporal Agencies solely for religious purposes. The guarantees and safeguards that this property, money and income could and would be used solely for these purposes are clear, numerous and effective.

(1) All officers and members of such an agency must be ecclesiastical members subject to the discipline of the Church (Const. VI, R. p. 26), that is, members entitled to positions of trust and confidence by reason of their religious beliefs alone (Canon Law 13 (8), R. p. 48-49).

(2) All temporal agencies must hold a charter from the Church government (Const. Art. VI, R. p. 26-27), one of the conditions of which is that it is subject to the Church laws (Canon Law 4 & 5, R. p. 34-35). Any transaction involving $10,000 or more must be approved by the Senior Elder whose determination is whether the transaction is calculated to

reduce or lose property subject to religious uses *and* whether the transaction will carry out the religious purposes (Canon Law 6, pp. 35-36). If any temporal agency does or suffers to be done anything that materially impairs the ability of the temporal agency to act for the Church or impairs its property for religious purposes, then (1) the Senior Elder, or (2) the Advisory Board, or (3) the Church judiciary on its own motion can suspend the powers of the Temporal Agency, thereupon the Church Judiciary shall designate a Temporal Agency to take possession of its property and upon notice the Church Judiciary shall have a hearing and decide the merits and who shall take the property as successor under the religious trust (Canon Law 7, R. p. 36-37). If the Senior Elder determines any charter is violated or Canon Law violated, he can suspend the charter, or the Church judiciary has this power (Constitution Art. VI (4), R. p. 26). If either the Senior Elder or Advisory Board find any property of a chartered agency of the Church is not being used according to the religious dedication, the property can be transferred to another temporal agency as in the Canon Laws provided (Const. Art. VI (5) R. p. 27). The Church judiciary has final determination in such matters (Const. Art. VI (6) R. p. 27).

(3) All property of the Church is held under an express trust for the benefit of the ecclesiastical organization (Const. Art. VI (7) R. p. 27-28 and Canon Law #3, R. p. 33) and the ecclesiastical matters are all important (R. p. 33).

(4) All property acquired by the Church or any of its activities or groups must be used exclusively for the religious purposes (R. p. 37-38), and all gifts and transfers are bona fide gifts to the Lord's work, unless there are conditions or understandings in writing approved by the ecclesiastical government. The Canon Law 8 (R. p. 37-38) specifically defines this consent shall be given only if the condition or understanding or promise will tend to carry out the religious purposes and such written condition or understanding or promise is necessary to carry out those religious purposes. Consent shall be withheld if such condition, understanding or promise in the discretion of the ecclesiastical head is likely to impair the religious purposes or subject other property subject to the religious purposes to undue risk or hazard. This Canon Law states the policy of encouraging gifts of real property to be subject to the condition that it be used solely for religious purposes.

(5) Gifts having a condition to maintain or support the donor or for support of any individual are prohibited (Canon Law 9, R. p. 39).

(6) Canon Law #10, (R. p. 39-40), specifically provides no money, income or property shall accrue to the personal profit or benefit of any person, persons or shareholders but all income of any group, project or temporal agency shall always be used for religious purposes and no amendment of the Canon Laws and no instrument under which any gift or conveyance is made shall permit any person to have any proprietary rights in any income. No Temporal

Agency shall ever issue any stock or certificate for payment of any income to accrue to the benefit of any individual or stockholder.

(7) Canon Law 11, R. p. 40-41 prohibits the use of any property to influence legislation or for propaganda. It prohibits any gift, conveyance or acquisition under which property may be used for such prohibited purposes.

(8) The personal profit from the Lord's purse is specifically prohibited as is any profit to any person to commercialization from property subject to religious trust (Canon Law 12, R. p. 41-43). No salaries, wages or compensation can be paid to any person for work, studies or effort in carrying out the religious purposes and all such services are bona fide gifts unless the person subject to the Canon Laws, (that is members and officers), has an express contract in writing with the person, group or organization defining the compensation and the writing is duly approved by the ecclesiastical government who shall not approve such a writing unless it is determined the compensated services are within the religious purposes and necessary to carry out those purposes (Canon Law 19, R. p. 51-52). Even expenses of travel, etc. cannot be paid without a Church official determining the sum is necessary and it will carry out the religious purposes (Canon Law 12, (1), R. p. 41).

(9) To meet the material needs of those persons, their families, and dependents who dedicate their work, services and studies to carry out the religious purposes, the Apostolic Society form of living is se-

lected as the means to accomplish these results within the doctrines of the Church (Canon Law 12, R. p. 41-42).

The apostolic form is that used by the early Church and is described in The Book of Acts.[1] The various members and their families live in groups and the Church provides such of their necessities as it sees fit. Those in the group donate so much as they wish to the Church (lay it at the feet of the Apostles). The Church has a common community Treasury for these needs. Peter, the Apostle, stated to Ananias and Sapphira that they were not required to give anything, but having sold some property it was wrong to give part and lie about the sum received from the sale.[2]

(a) Canon Law 12 (2) provides for the common community Treasury. The Church government had designated the Elected Delegates Committee as the temporal agency to handle this common community Treasury (R. p. 103).

(b) The ecclesiastical government designates how much is necessary (Canon Law 12 (4), [R. p. 42] and R. p. 117, 118, 125, 126) for the common community Treasury to carry out the religious purposes through

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[1]Acts 2:44-7; Acts 4:32-7.

In the New Testament published by St. Anthony Guild Press, Paterson, N. J. at page 325 appears a footnote to Acts 2:44 wherein it is stated the early Christians held the property in common. "In common. All were ready to help the needy, and as occasion demanded, they sold their possessions to do so; this spirit of fraternal charity is widely different from modern Communism."

[2]Acts 5:1-11.

the Apostolic Society form of living. Thereupon the various temporal agencies are authorized to make available money or property as a religious purpose up to the amount so determined.

(3) From among the facilities owned or controlled by the various temporal agencies, the ecclesiastical organization specifies those to be used for living accommodations and the temporal agency is authorized to use such property as a religious purpose as directed (Canon Law 12 (5), R. p. 42-43).

(d) Only the ecclesiastical organization can determine the amounts for benevolences.

(e) Only the ecclesiastical organization can designate who, including those not Church members, can be fed, lodged or supported by the temporal agency as a charitable or helpful act in illustrating the teachings and purposes of the Church.

(10) Canon Law 17, (R. p. 50) provides there shall be no legal obligation for giving or paying money as a condition of office, or membership. Canon Law 18 provides there shall be no financial liability or property rights accrued by reason of Church membership or office.

(11) Canon Law 20 (R. p. 52), specifically states no person has any right, title or interest to any Church property by reason of membership or office. It states all property shall be used exclusively for religious purposes of the Church.

(12) It is made a specific offense triable before the Church judiciary for any person subject to the

Church disciple to attempt to divert property of any temporal agency from its religious uses or misuse such property, contrary to the doctrines of the Church.

(13) The Church judiciary is given full and final jurisdiction in all Church matters, including property. Any person in the Church may invoke its jurisdiction. Only in disciplinary proceedings may its punishment be changed by the Senior Elder, to reduce the punishment or grant clemency (Canon Laws 30 to 37, R. p. 58-67).

The Tax Court stated in its decision (R. p. 95):

> "The Church has no church buildings. Its principal reliance is on having its members live in a manner exemplifying Christ's teachings, particularly by living in a selfless manner. Its stuent minister training projects, while engaging in commercial activities, were designed to permit the public to witness the application of Christ's teachings to everyday life. Thus the very means chosen by the Church to attain its spiritual purposes involve engaging in commercial activities through its principal temporal agency, the Committee . . ."

QUESTIONS ON APPEAL.

(1) Whether related income during 1948 and 1949 of a Church from activities of student minister training and spreading of the Church's religious teachings, which activities produce revenue, and which revenue by the organic Church law must be used for religious purposes only, and are so used, disqualifies the organ-

ization from exemption under Int. Rev. Code, Sect. 101, Subdivision 6.

(2) Whether Christ Church of the Golden Rule, and its principal temporal agency, The Elected Delegates Committee of the Ecclesiastical Society of Christ Church of the Golden Rule are exempt organizations and gifts to them by the appellants in 1948 and 1949 are deductible under Section 23 (0) Internal Revenue Code of 1939 up to 15% of income.

(3) Whether appellant Grassmee is entitled to dependency exemption of her dependant mother for 1948 and 1949.

(4) Whether appellant Riker is taxable for the income of a related religious activity of the religious apostolic group of which she was but a member and local official and which income was the product of the service of that group and of the property, fixtures and equipment bought and owned and later sold by the Church committee.

(5) Whether appellant Riker as a member of an apostolic religious society with a common community treasury who files its return as such under Rev. Code 101 (18) and whose members file their tax return showing the distributive share, whether received or not, is taxable upon more than her distributive share.

(6) How a member of a religious apostolic society with common community treasury which members and organization report the organization's income under Internal Rev. Code, Section 101 (18), are taxable; whether for the amounts received and remitted to the

group or upon the proportional distributive share, whether received by the member or not.

(7) Whether appellant Riker is taxable for actual net income of her religious group paid to her Church, or for some $2,969.00 additional reported by mistake but not actually received by her or her Church.

The Grassmee case involves solely, (1) whether she is entitled to 15% deduction under Section 23 (0) for the money given to her Church with Church form No. 399 stating it was for religious purposes (point on appeal No. 2), and (2), whether because she lived in the Apostolic Society with her dependant eighty-four year old mother, she should file her return as a member of a family group, including in her return her distributive share and that of the others in her family unit and listing each exemption of each person in the family unit or whether each person in the family group, whether an aged mother or a small child, each should file separate and distinct returns showing but one share or dividend under Section 101 (18) and each claiming only his or her individual exemption (point on appeal No. 3).

The Riker case raises numerous questions of income tax under Section 101 (18) on apostolic religious societies:

(a) Whether the spiritual head of a group is taxable for any revenue arising as an incident to the ministry of the group from the group's efforts, using the Church's property, and all the gross receipts being deposited forthwith to the Church and expenses connected therewith being paid by the Church. This

is point No. 4 in which the Commissioner seeks to charge Riker income tax on the income of the Church project at San Bernardino.

(b) Whether Mrs. Riker who made a return of the fractional shares of the Apostolic Society under Section 101 (18) for both herself and her six year old daughter is taxable on more than this by reason of her religious office or membership in the Church or whether she is taxable for income of this religious society which she handles for the group, in addition. This is question 5, 6 and 7.

(c) Whether a person in an apostolic religious association:

(1) Reports income of the individual donated to and reported as part of the gross income of the society upon which all of the members are taxed a proportional amount; and deducts a maximum of 15% of that donation to the Church under Section 23 (0). This results in double taxation, first to the party earning it; then to the various individual members including this same taxpayer, as part of their distributive share.

(2) Reports only the proportional income of the association, which includes the group income from donations, and pays taxes thereon under Section 101, Sub. 18, and whether the proportionate share of the donations taxed to each are subject to the 15% deduction of Section 23 (0).

SPECIFICATION OF ERROR.

Appellant Grassmee specifies as error the refusal to allow her deductions in either 1948 or 1949 for gifts to her Church up to 15% for adjusted gross income under Section 23 (0) and the disallowance of the exemption of her dependent mother in the returns by family group wherein she listed the income of herself and eighty-four year old mother and took the exemptions of both in the group for whom she made a return.

Appellant Riker specifies as error the taxing her as an individual for all the income arising as an incident of the religious activities and ministry of the San Bernardino group of whom she was the spiritual head and teacher which income was the product of the efforts of the entire group whose living expenses were paid by the Church, not her, and which group received no remuneration, and which income was the product of the investment of and owned by the Church and which income included exhaustion (depreciation) of equipment owned by the Church. Appellant Riker specifies the Commissioner erred in refusing any deduction under Section 23 (0) for the product of her labor which the Church received.

Appellants specify as error the holding of the Tax Court that their Church and its temporal agency, The Elected Delegates Committee, were not organized and operated exclusively for religious purposes, no part of the income inuring to the benefit of any individual or shareholder, and no part of whose income is used for propaganda or to influence legislation, because:

> stantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation.
>
> to an amount which in the above cases combined does not exceed 15% of the taxpayer's adjusted gross income . . . "

It is the policy of the law to encourage support of religious, charitable, scientific, literary, and educational organizations by private donations. Not only are these organizations encouraged and developed to the end that the general benefit of individual efforts along these lines accrue to the public but also the encouragement of the individual taxpayer to partake in the worthy causes it encourages.

The Courts have construed these provisions of the law liberally. A taxpayer having in good faith made a donation to a religious organization or for the use of such an organization is not to have his or her deduction subsequently denied and suffer a deficiency assessment for mere technical reasons or because the taxing authorities take a restricted view of a particular religion or religious practices of the beneficiary of the donor's bounty.

In actual practice, the taxing authorities disallowance of this deduction has a severe crippling and destructive effect on any religion. This power of the taxing authority can be the basis of discrimination within the First Amendment of the United States Constitution, for private contributions and donations are the life blood of any religion's activities, its power to expand or even survive. Few but the most devout

will continue to support a Church knowing there is certain to be income tax audits, income tax trouble and deficiency assessments if they so much as give financial support to the religion of their choice. Nothing is calculated to discourage financial support of one's own religion than a knowledge that the mere giving and contribution is certain to entail a careful audit of one's return, conferences with the taxing agencies and certainty of a deficiency assessment. How much stronger this effect is as a discrimination and detriment, to the particular religious cause at bar where the concept of Christianity involves the living of a selfless life like Christ, and the donor and contributor such as Grassmee and Riker who gave all their money as they received it to their Church. The very concept of the apostolic religious form of living which is recognized by Congress and regulations of the Commissioner of Internal Revenue, are struck a deadly blow when those living in this recognized form of religious activity are singled out for assessments, disallowing their gifts to their Church, which gifts are included in the income of the group and the pro rata share thereof reported and taxed as income to each member of the group. The contributors and donors are ascertained from their Church's records and returns and penalized by income tax assessments for their religious beliefs and zeal in advancing their religious crusade.

The policy of the law is contrary to this strict view and the Constitutional right of religious freedom abridged, infringed and made the subject of administrative action and personal liability.

A.

This provision by statute excepting gifts and donations is begotten from motions of public policy and is not to be narrowly construed.

Helvering v. Bliss, 293 U.S. 144, 55 S.Ct. 17, 79 L. Ed. 246;

Harrison v. Barker Annuity Fund, (CCA-7) 90 F. 2d 286;

Cochran v. Comm'r, (CCA-4) 78 F. 2d 176;

Roche's Beach Inc. v. Comm'r, (CCA-2) 96 F. 2d 776.

This section is to be liberally construed, it being remedial in character.

Seasongood v. Comm'r, (CCA-6) 227 F. 2d 907.

A gift to an irrevocable trust which includes charitable purposes for beneficiaries, kin of the donor (preference directed to worthy descendent's of the donor's father), is a deductible gift.

Schoellkopf v. U.S., (CCA-2) 124 F. 2d 982.

A gift to the donor's grand Army Post is deductible. The character of the donee corporation is to be determined by its articles which was a nonprofit corporation intended for relief of its members, etc.

Duffy v. Pitney, (CCA-3) 2 F. 2d 230.

Voluntary gifts to an unincorporated association whose purposes was to pay pensions to Gimbel Bros. employees, pay for life insurance of their employees, extend relief to those employees, and provide certain

scholarships, are deductible gifts. It does not defeat the exemption because the charity is restricted to a class.

Gimbel v. Comm'r, (CCA-3) 54 F. 2d 780.

A gift to an association is none the less deductible because it is for awards to citizens. The motive of the gift is the test and it is still charitable though it extends to both rich and poor.

Bok v. McCaughn, (CCA-3) 42 F. 2d 616.

A gift to World League Against Alcoholism is deductible as an educational purpose though it advocates, collects and disseminates information about prohibition and use of alcohol. The Court points out a university may have a professor who advocates controversial matters and a library can contain books of a controversial nature, but neither are less educational thereby.

Cochran v. Comm'r, (CCA-4) 78 F. 2d 176.

A gift to an unincorporated association of members of the donor's family and the association made gifts to indigent individuals who were old family retainers ($2257 given in year to 9 individuals) is deductible.

Havemeyer v. Comm'r, (CCA-2) 98 F. 2d 706.

A gift is deductible under Section 23 (o) when made to a fund organized and controlled by a non-exempt organization, where the purpose of the fund is within the section. This section is based on public policy to encourage donors for the listed purposes.

Faulkner v. Comm'r, (CCA-1) 112 F. 2d 987.

A gift is deductible when made to the League for Industrial Democracy which does research, makes lectures, debates and discussions and promotes pamphlets and books concerning economic and social problems. The fact the donee organization may be like or unlike a political party does not remove it from its educational work and education is the imparting and acquisition of knowledge, mental and moral training not restricted to the narrow concept of instruction.

Weyl v. Comm'r, (CCA-2) 48 F. 2d 811.

The fact that the donor receives an incidental benefit from a trust to which the gift for civic and charitable purposes was made does not defeat the exemption.

Johnson v. U.S., (DC-Tex.) 8 Fed. Supp. 842.

A gift is deductible under Section 23 (o) when made to I AM reading room for religious, educational and charitable purposes of that religious movement.

Potter v. U.S., (DC-Ill.) 79 Fed. Supp. 297.

A gift to Hamilton County Good Government League is deductible under Section 23 (o) though the donor was a principal backer and officer in it, the organization sponsored political candidates, sponsored and opposed various legislation. The Court pointed out only 5% of the time and effort went to propaganda which it defined as enlightening people in matters of politics and the substantial activities were

within that section. The Court in determining the gift deductible held that section was to be liberally construed and was remedial in character.

Seasongood v. Comm'r, (CCA-6) 227 F. 2d 907.

The facts in the Riker and Grassmee cases, indicate a strong factual situation justifying the public policy and remedial character of the section. One making a gift to one's own church for religious purposes should have the same liberal rules applied as indicated by the above decisions which are but a few of the many holdings in the various reported decisions.

B.

It should be pointed out that a gift to a non-exempt organization has been held deductible where the gift is "for the use of" the purposes under Section 23 (o).

In *John Danz,* 18 T.C. 454 (1952), Section 23 (o) uses the language "to *or* for the use of". It shows that gifts for religious, charitable, scientific, literary or education purposes are intended by Congress to be deductible from gross income in computing taxable income. In the case at bar *all* donations (R. p. 109) were made and accompanied by a written instrument (Exhibit 8) that stated the gift was to be used solely for religious purposes (finding, R. p. 83) of the Church. The first paragraph of Exhibit 8, Church Form 399 reads:

"Transmitted herewith is an outright gift of:
.....($.....)
Amount of item
to the Elected Delegates Committee of The Ecclesiastical Society of Christ's Church of The Golden Rule, to be used by them exclusively for religious purposes of the Church.
.....

.....
Sign in Ink—Name in Full"

Such language, per se, in a written document would and does create a gift in trust for the religious purposes. If made to any person, clearly not an exempt organization as for example a trust company, private person or a group of individuals it would be a gift in trust, enforceable in a competent Court, and recognized as a valid and deductible gift for religious purposes within Section 23 (o). The facts are doubly strong when the gift goes to a committee of the Church, chartered under its Church Constitution and Canon laws (finding, R. p. 82) that provides the money and property be held upon a trust for religious purposes (Canon Law No. 20, R. p. 52) and the spiritual body (Ch. Const. VI (7) R. p. 27-8); Canon Law No. 3, page 33; No. 8, pages 37-8) and that contains the numerous safeguards and remedies (R. p. 20-67) heretofore detailed in this brief.

This question of deduction of gifts accompanied by this written statement, to this Church with these Canon laws, is of vital importance to numerous members of this Church whose cases are pending in the

Agent's office. This is a test case to determine the points of law. (See affidavit to amend petition, R. p. 74-6.)

II.

THE CHURCH COMMITTEE IS AN EXEMPT ORGANIZATION UNDER SECTION 101(6) AND A RELIGIOUS ORGANIZATION WITHIN SECTION 23(o).

A *Section 23 (o)* organization or fund or trust is one organized and operated exclusively for religious purposes, no part of the net income of which inures to the benefit of any individual and no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation.

Section 101 (6) provides:

> "The following organizations shall be exempt from taxation under this chapter—(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;"

The Elected Delegates Committee received all its donations and Student Minister Training Application funds accompanied by a written Church Form No. 399 that specifically stated the property was solely for the religious purposes of the Church (finding,

R. p. 83, Exhibit 8, R. p. 109). It administered a trust or fund solely and exclusively for the religious purposes.

In addition to this Church Constitution and Canon laws specifically spell out and provide for the use of the money and property exclusively for the religious purposes (Church Const. VI, subd. 7, R. p. 27-8, Canon Laws No. 20, R. p. 52; No. 3, R. p. 33; No. 8, R. p. 37-8). Canon Law No. 20 (R. p. 52), prohibits any person from having any interest in any of the Committee's property. Canon Law No. 25 (R. p. 56) makes it an offense for any person in the Church to direct or misuse property of the Committee from its religious uses, punishable by the Church judiciary, a separate branch of the Church organization. Canon Law No. 19 (R. p. 51-2) provides for safeguards so that the temporal agency cannot draw money under excuse of salaries, and an ecclesiastical officer (a separate organization) must find the written contract of remuneration is within the religious purposes and necessary to carry these purposes out. Canon Law No. 10 (R. p. 39-4) specifically prohibits any income of the Committee to inure to the benefit of any person, shareholder or certificate holder, but all income of any temporal agency, group, etc. within the Church must be always used for the religious purposes of the Church.

Canon Law No. 11 (R. p. 40) specifically prohibits any property of the Committee or other temporal agency from being used for propaganda or influencing legislation and Canon Law 21 (R. p. 52-3) prohibits

any person in the Church from using his office or connection or membership for political purposes, to promulgate or spread propaganda or to influence legislation. The safeguards to enforce and implement these organizational laws are many. They can be initiated by the spiritual head (Senior Elder) or by the spiritual legislative body (Board of Elders) or by the Church judiciary. Any member may initiate the action in the Church judiciary. The membership can by a demand of 25% of the members convene a convention of elected representatives with full power to declare any office vacant and fill it by majority vote and can amend any doctrine or ecclesiastic ruling (Const. IX, R. p. 29-30).

Although the law on exempt organizations was changed in 1951, the statute Section 101 (6) and Section 23 (o) in the years 1947 through 1949 involved in this case, has been the subject of many judicial decisions.

A.

One test sometimes applied to organizations to determine whether or not they are exempt within Section 101 are the instruments that create them, that is their charter and organizational laws. Any act outside of those would be *ultra vires* and the purposes and powers prescribe the authority and sphere of action.

Harrison v. Barker Annuity Fund, (CCA-7) 90 F. 2d 286;

U.S. v. Proprietors of Social Law Library, (CCA-1) 102 F. 2d 481.

B.

Most of the circuits have applied the "ultimate destination" rule in determining whether a commercial enterprise is exempt under Section 101 (6). Stated another way, whether its purpose is to devote its profits to religious, charitable or educational purposes is the test of whether the organization is exempt or not.

Roche's Beach Inc. v. Comm'r, (CCA-2) 96 F. 2d 776;

Koon Kreek Klub v. Thomas, (CCA-5) 108 F. 2d 616;

Debs Memorial Radio Fund v. Comm'r, (CCA-2) 148 F. 2d 948;

U. S. v. Pickwick Elec. Membership Corp., (CCA-6) 158 F. 2d 272;

Bohemian Gymnastic Assoc. v. Higgins, (CCA-2) 147 F. 2d 774;

Willingham v. Home Oil Mill, (CCA-5) 181 F. 2d 9;

Scofield v. Rio Farms, Inc., (CCA-5) 205 F. 2d 68;

Crooks v. Kansas City Hay Dealers Assoc., (CCA-8) 37 F. 2d 83;

Mueller Co. v. Comm'r, (CCA-3) 190 F. 2d 120.

There are cases to the contrary involving hard facts as where only a small part of the earnings actually go to the exempt purposes as *U.S. v. Community Services,* (CCA-4) 189 F. 2d 421 where a business corporation was formed to operate a canteen for a specific mill, and although the articles of incorpora-

tion provide for all the profits to be used for religious, charitable and scientific purposes, the record shows that only a small part of the receipts were earnings and only a portion of the earnings were used for the exempt purposes and the balance used by the corporation or set aside as a reserve. This *Community Service* case was disapproved by the Court of Claims in *Sico Co. v. U.S.,* 102 Fed. Supp. 197 on the authority of *Mueller v. Comm'r,* (CCA-3) 190 F. 2d 120, and the *Mueller* case is directly contrary.

In *Scofield v. Rio Farms, Inc.,* 205 F. 2d 68, the 5th Circuit in passing on a capital stock tax imposed on a corporation created to meet social problems and assist from within a certain tract to improve and benefit their situation, which farmers were not the recipients of charity, held the liberal construction is to be accepted in favor of the exemption, and held the use of the profits and not the source determines the exemption. The 5th Circuit held that the weight of the authority is with this rule and cited *Koon Kreek Klub v. Thomas,* 108 F. 2d 616 and *Willingham v. Home Oil Mill,* 181 F. 2d 9 that liberal construction be applied in favor of the exemption.

It appears from language in *Retail Credit Association of Alameda Co. v. Comm'r,* (CCA-9) 90 F. 2d 47, citing *Crooks v. Kansas City Hay Dealers Association,* (CCA-8) 37 F. 2d 83 and *Trinidad v. Sagrada Orden,* 263 U.S. 578, 44 S.Ct. 204, 68 L. Ed. 458 and from the language in *Smyth v. California State Automobile Association,* (CCA-9) 175 F. 2d 752, that it is the purpose to which the income is devoted which

determines whether or not the exemption exists, citing *Koon Kreek Klub v. Thomas,* (CCA-5) 108 F. 2d 616 and *Trinidad v. Sagrada Orden,* 263 U.S. 578 that this circuit might favorably consider this rule as the law of this circuit.

C.

In *Squires v. Student Book Corp.,* (CCA-9) 191 F. 2d 1018 this circuit stated it was an open question as to whether the "ultimate destination" rule were to be followed and indicated that in the *Smyth* case (175 F. 2d 752), the ultimate destination rule was cited with approval, that the law as to exempt organizations was changed in 1950, effective in 1951, and that a book store run by a commercial corporation whose stock was owned by Washington State College regents under a trust for the benefit of the Associated Students was exempt. The Court held "The business enterprise in which the taxpayer is engaged bears a close and intimate relationship to the College itself" as the test of the exemption. In this case the corporation sold books to the faculty and students and ran a kitchen and restaurant for the students. The income was used for the construction of the Student Union and the acts of the Associated Students was subject to the approval of the College President.

Some decisions apply the test that there must be a primary purpose for which the organization is founded within the exempt purposes such as religious, charitable or educational. These decisions recognize

that money is essential to the conducting of any such purpose. If the organization to obtain the means of carrying on its purpose engages in some commercial enterprise, though not necessarily connected therewith or related thereto, the organization is still exempt under Section 101.

The 9th Circuit in *Retail Credit Association of Alameda County v. Comm'r.,* 90 F. 2d 47, adopted this rule of primary purpose and held that where an ordinary business for profit is purely incidental to the main or principal purpose as in *Crooks v. Kansas City Hay Dealers' Association,* (CCA-8) 37 F. 2d 83, and *Trinidad v. Sagrada Orden,* 263 U. S. 578, the organization is exempt. The Court held that in determining whether a purpose to engage in a regular business of a kind ordinarily conducted for profit is merely incidental or subordinate, each case must stand on its own facts. In that case the Court held that although there was no exemption and the organization acting as a collection agency and credit reporting bureau for fees and charges and was conducting a business not incidental to a main or principal purpose, there was nothing in the statute or regulations prohibiting any exempt organization from engaging in any form of business. The purpose was the test.

Crooks v. Kansas City Hay Dealers' Association, (CCA-8), 37 F. 2d 83, held that charging of fees to inspect and weigh hay by the voluntary association of the market dealers was incidental to the main purpose to give integrity to the hay market. The Court

held that the fact that an organization receives some income to carry on its work is no proof it was organized for the sake of profit. The test was the main purpose and the ultimate destination of the profits and property acquired.

Koon Kreek Klub v. Thomas, (CCA-5) 108 F. 2d 616, in holding a fishing and hunting club owning 6,777 acres and who let land for livestock (its articles authorized it to raise livestock for profit) and used the income for organizational purposes was held an exempt organization. The decision pointed out that the financial gain was incidental to and directed toward the accomplishment of its purposes; that the statute says nothing of the source of the income, but ultimate destination is the test. The decision recognizes the necessity of an organization having money to carry on its exempt purposes and observes that deriving funds for this purpose is no departure.

Willingham v. Home Oil Mill, (CCA-5), 181 F. 2d 9, involved a business corporation whose stock was bequeathed to a trust and whose articles were amended to require its purpose to be religious, charitable and educational and no net income of which could inure to the benefit of any individual. The decision quotes Marshall in the Dartmouth College Case that if a civil institution were employed in the administration of government it would be a public corporation and draws the analogy to where a private corporation be employed in administering for religious, charitable and educational purposes. The Court

held the sole purpose was to devote the net income to the exempt purposes and it was an exempt organization.

Bohemian Gymnastic Association v. Higgins, (CCA-2) 147 F. 2d 774 involved the conduct of a bowling alley, kitchen, bar and restaurant as an incident to the main purpose of a gymnasium for educational purposes. The Court in holding the organization exempt, followed the ultimate destination rule and held these fund raising businesses incidental to the main educational purpose. The Court held that the exemption was not to be denied a religious or charitable organization which raises its money through some business not its principal object. Dues are not a test, either.

U. S. v. Pickwick Elec. Membership Corp. (CCA-6) 158 F. 2d 272 involved a corporation organized to distribute T.V.A. power. The Court held it was organized and operated for purposes under two Subdivisions of Section 101, and these sections are cumulative and not mutually exclusive. The Court held its principal purposes not a commercial one, and although it served both members and non-members making a charge to them which resulted in a profit, it only provided a prudent margin of safety and over a period of time operated on a non-profit basis. Here again the test was ultimate destination coupled with its principal purposes being exempt purposes. The Court recognized the need for money to effect the exempt purpose, even to retaining a safe margin to be able to carry these purposes out over a long period of time.

Debs Memorial Radio Fund v. Comm'r, (CCA-2), 148 F.2d 948, involved a radio station that made charges to the public for radio time and used its money for its educational purposes for which it was exempt. The Court followed the ultimate destination rule. The facts indicate a business related to its principal purpose, the need for funds to effect that purpose and its principal purpose was educational and the revenue was only incidental.

Comm'r v. Orton, (CCA-6) 173 Fed. 2d 483 held a foundation an exempt organization. This foundation was created by will of Orton, an engineer and on Ohio State University faculty, to manufacture and sell for a profit cones for testing heat in ceramic manufacture and use the net profit of 20% of sale prices to do further research in the ceramic industry. The Court held that this was a foundation to promote science or art and the manufacturing business was not run in a vacuum but was related to the objective of good ceramic manufacture and the profit for research; and distinguished ordinary business enterprises that were run solely for personal financial gain.

D.

The leading case on religious exempt organizations is that of *Trinidad v. Sagrada Orden,* 263 U.S. 578, 44 S. Ct. 204, 68 L. Ed. 458 in which the corporation sole of the established Church in the Philippines held large properties from which it collected rents, owned stock in private corporations, loaned money at interest

and received small sums from alms and sale of supplies as chocolate, wine, etc. connected with its religious work. All of the income was devoted to the religious work of that Church. Suit was brought for return of income tax, claiming the corporation sole was exempt as a religious organization. The Supreme Court held (263 U.S. at 581):

> "Whether the contention is well taken turns primarily on the meaning of the excepting clause, before quoted from the taxing act. Two matters apparent on the face of the clause go far toward settling its meaning. First, it recognizes that a corporation may be organized and operated exclusively for religious, charitable, scientific or educational purposes, and yet have a net income. Next, it says nothing about the source of the income, but makes the destination the ultimate test of exemption.
>
> "Evidently the exemption is made in recognition of the benefit which the public derives from corporate activities of the class named, and is intended to aid them when not conducted for private gain. Such activities cannot be carried on without money; and it is common knowledge that they are largely carried on with income received from properties, dedicated to their pursuit. This is particularly true of many charitable, scientific and educational corporations, and is measurably true of some religious corporations. Making such properties productive to the end that the income may be thus used does not alter or enlarge the purposes for which the corporation was created and conducted. This is recognized in *University v. People,* 99 U.S. 309. . . .

> "The plaintiff, being a corporation sole, has no stockholders. It is legal representative of an ancient religious order, the members of which have, among other vows that of poverty. According to the Philippine law under which it was created, all of its properties are held for religious, charitable and educational purposes; and according to the facts stipulated it devotes and applies to those purposes all of the income-rents, dividends and interest from such properties. In using the properties to produce income, it therefore is adhering to and advancing those purposes, and not stepping aside from them or engaging in a business pursuit."

In *Retail Credit Association v. Comm'r,* (CCA-9), 90 F. 2d 47, it was pointed out that the trade in chocolate, wine, etc. for profit in the *Trinidad* case (supra) was purely incidental to the religious purposes. It is clearly a "related" business under the present law on exempt organizations.

The present law on exempt organizations, although not applicable to these two cases because it became effective in 1951 now turns on "related business income" thus following the rule of *Trinidad v. Sagrada Orden,* 263 U.S. 578.

26 *U.S.C.A.* 511 (1954 Internal Revenue Code) taxes *unrelated business income* which is any trade or business, the conduct of which is not substantially related (aside from need) to exercise or performance of its charitable, or educational purpose. Where substantially all the work is carried on by the organiza-

tion without compensation, as in the Student Minister Training Program of the Church, it is not taxable. The tax does not apply to churches. 26 U.S.C.A. 511.

The Tax Court in the instant cases found (R. p. 82-83):

> "In operation, activities of the Church members are of two types. Some members devote all of their time to working on Church projects and studying to be ministers of the Church's teachings. These are called student ministers, and they live in the apostolic societies called 'Student Minister Training Projects'. One purpose of these projects, most of which are engaged in commercial activities, is to spread the teachings of the Church by having the public witness the application of those teachings in everyday life. Some projects were not engaged in commercial activities but simply operated residential facilities for the Church members. Members living in both types of projects contributed their earnings to the Church. Other Church members lived at home and participated in Church activities. The Church operated a theological seminary."

The decision of the Tax Court also states:

> "The Church has no church buildings. Its principal reliance is on having its members live in a manner exemplifying Christ's teachings, particularly by living in a selfless manner. Its student minister training projects, while engaging in commercial activities, were designed to permit the public to witness the application of Christ's teach-

> ings to everyday life. Thus the very means chosen by the Church to attain its spiritual purpose involve engaging in commercial activities through its principal temporal agency, the Committee, . . ."

The Church Committee filed a Form 990 return for September 1947 to 1948 (Exhibit 2) and for September 1948 to 1949 (Exhibit 4, finding page 84) as an exempt organization under Section 101, Subdivision 6, showing the facts required.

The Canon Law No. 12 provided that those who devoted their time and efforts to the Lord's work should have it made possible by meeting their needs and those of their families and dependents so they could devote their time, by the apostolic form of living. The Spiritual body officials determined how much was the budget therefor. The Committee then met those needs as a religious purpose. Only bare necessities were provided (R. p. 134, 118-119) and covered all living expenses of food, clothing, doctor bills, medication, etc. (R. p. 119). The group at San Bernardino of a dozen or more (R. p. 116) lived on a ranch and consequently produced much of their food, and therefore received less than average (R. p. 148). The total Student Minister Maintenance for fiscal year 1948 of 575 individuals was $202,890.47. (R. p. 122) which is $351 per person per year or $30 per person per month. This shows a frugal existence. The testimony shows the members were dedicated to a religious crusade and gave freely and liberally of their income to it. They certainly never carried on or joined this

crusade for personal gain. The bare existence was necessary but wholly incidental to the religious crusade.

The evidence and findings shows the so-called commercial enterprises but a means of application of Christianity to everyday life. It was a laboratory to apply the religious studies. It was the means of spreading their teachings of Christ as they believed it. It was their ministry.

Projects were selected and maintained upon the basis of more widely spreading the Church teachings by having the public come in contact with the student ministers in training, and to make it possible for the student ministers to express and live in their daily activities the teachings of the Church (R. p. 115-116). The business operation was wholly incidental (R. p. 119). Some ran at a loss and the consideration of maintaining and continuing them was solely whether or not it was serving the purposes of promulgating the Church's teaching and its ministry (R. p. 120). The only salaries paid were those to personnel outside of the Church where a particular skill or training were needed and none were in the Church (R. p. 123). No one in the religious society was paid any salary (R. p. 123). Any excess above actual operation went to publications (R. p. 124), and to expanding the religious work through more facilities to permit others to learn this concept of religion (R. p. 126-127). It did not go to any better living for those in the ministry or their families (R. p. 126).

The expense of the so-called businesses which were an incident of and means of practicing, spreading the teachings of the Church were actually operated at a loss for the costs of supplies, power, etc. of the Student Minister Training plus the costs of the support of the labor in them, (Student Minister Maintenance), fell far short of the income (Student Minister Application) and the difference was made up by substantial gifts $137,491 (R. p. 121) and exhaustion of resources owned and used by the Church Committee. See Exhibits 2 and 3 for 1947-1948 and 5 and 6 for 1948-1949. They were not profitable in any sense of the term measured by commercial or accounting means. Measured by spiritual results and spreading of Christianity they were highly valuable.

That a Church would believe enough in Christianity to show the public by actual example to those who came in contact with it, does not make it any the less a religious activity or its purpose any the less a religious purpose. Its sole purpose is religion. That it uses a less conventional or a unique mean does not make it any the less an exempt organization.

Any so-called commercial activity was purely incidental to and bore an incidental relationship to its religious purposes and was solely to carry out those religious purposes. It was related to the performance of its religious purposes.

III.

AN APOSTOLIC OR RELIGIOUS SOCIETY IS AN EXEMPT ORGANIZATION UNDER SECTION 101, SUBDIVISION 18.

The statutes in effect in 1947 to 1949 by specific provision exempt Religious or Apostolic Societies from income tax. Section *26 U.S.C.A. 101 (18)* provides:

> "101. The following organizations shall be exempt from taxation under this chapter—
>
> '(18) Religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even if such associations or corporations engage in business for the common benefit of the members, but only if the members thereof include (at the time of filing their returns) in their gross income their entire pro-rata shares, whether distributed or not, of the net income of the association or corporation for such year. Any amount so included in the gross income of a member shall be treated as a dividend received.' "

In the cases at bar of Grassmee and Riker, the Religious Association, Elected Delegates Committee of the Ecclesiastical Society of Christ's Church of the Golden Rule, filed its returns as required by the Commissioner's Regulations for Subdivision 18 by filing the form 1065 return (partnership form) reporting as such all gross funds from all sources for both year 1947-1948 and 1948-1949 according to its fiscal year (Exhibits 3 and 5). Atached to each return as filed was the list of names of all members, 575 for 1947-1948 and 602 for 1948-1949 (R. p. 106).

The 1947-1948 returns of the Committee reported:

Application of Student Minister Training	$347,489.99
Donations	137,491.45
Total Gross Income	$484,981.44
Operating Expense of Student Minister Activities:	
Materials and Supplies	$ 54,828.74
Operating Expense (incl. repairs, maintenance, etc.)	55,911.20
Wages to non-members	21,216.27
Transportation (incl. oil and gas)	48,195.29
Rentals paid for projects	71,996.23
Insurance (plant, liab., etc.)	5,153.01
License fees	2,798.23
Taxes (sales, property, etc.)	8,924.30
Overhead (incl. advertising, legal, management, etc.)	9,900.37
Religious Publications and Schools	9,247.09
Total	$288,170.73
Student Minister Maintenance, (clothing, dental, eye glasses, food, household, medical, personal incidentals, housing utilities, recreation, etc.)	$202,347.04
Total	$490,517.77

Of the gross receipts of $484,981.44, there was an actual cash deficit of $5,536.33 and the 1065 return did not deduct any expenses other than those connected with the so-called commercial activities used to illus-

trate the Church teachings and the ministry of the Church and training of the student ministers. It showed actual $217,001.54 net income (omitting the Student Minister Maintenance, the Religious Publications and Schools, and payments to principal on notes and mortgages).

The members filed their individual returns for the year, including in each of their gross income the pro-rata share of 1/575 of the $217,001.54 of the Church Committee.

Riker. Attached to her return for 1948 (Exhibit 6, pages 107-108) was a mimeographed sheet which showed the fact of receipt of $8,959.11 and stated:

> "However, under the rules of the apostolic society (of which taxpayer is associated) that all in the society share their income $8,959.11 was contributed to and became a part of the income of the society, and is reported as a part thereof. Taxpayer would therefore be taxed twice on the same income by reporting as wages and also as dividend. For this reason, this latter sum is reported only as part of the dividend or taxpayer's pro-rata share of the net income of said apostolic religious society (See Item No. 3 Dividend).
>
> "Item 3. Dividend. 1/575 interest in $217,001.54 net income of The Elected Delegates Committee of the Ecclesiastical Society of Christ's Church of The Golden Rule, an Apostolic Religious Association, for its accounting period of October 1, 1947 to October 1, 1948. This was not received as a dividend, but is reported under Section 101(18) per person in Association $377.39.

"Number of persons in taxpayer's family who were in association and obtained support for Society during period:
2 times $377.39——$754.78."

Mrs. Riker had a six year old daughter and thus returned as a family unit on the face of her return the $754.78 as the pro-rata share or dividend as income.

Grassmee. Attached to her return for 1948 was the same mimeographed sheet and showed she was employed and had wages, all of which she gave to the Church. She lived with her 84 year old mother in the Church group and so she returned dividends or pro-rata shares for two persons of $754.78 (Exhibit 11).

Mrs. Grassmee for 1949 filed her return attaching a similar sheet showing her wages of $1,312.50 in her employment by Paul W. Sampsell and that all of this was contributed to the Church and included in the income of the Apostolic Society income tax return. She showed her dividend for herself and her 84 year old mother (Exhibit 12).

"1/602nd interest in $190,337.32 net income of the Elected Delegates Committee of the Ecclesiastical Society of Christ's Church of The Golden Rule, an Apostolic Religious Association, for its accounting period of October 1, 1948 to October 1, 1949. This was not received as a dividend, but is reported under Section 101(18)—per person in the Association, $316.17.

"Number of persons in taxpayer's family who were in the Association and obtained support from the Society during period:
2 times $316.17——$632.34."

All of the others in the Apostolic Religious Society filed similar returns.

The Committee as the common community treasury filed the tax return as an Apostolic or Religious Society following both the spirit and letter of the law (26 U.S. CA 101(18)) and the regulations. So did the members who reported a pro-rata share.

By express terms of the statute, 26 *U.S. CA* 101 Subdivision 18, the organization is thus an exempt organization even though it could engage in business as a primary purpose (which it did not).

A.

An organization can be exempt under two subdivisions of Section 101, for they are cumulative and not mutually exclusive.

U. S. v. Pickwick Elec. Membership Corp., (CCA-6) 158 F. 2d 272.

B.

The provisions of Subdivision 18, Section 101 concerning Apostolic or Religious Associations have not been the subject of judicial reported decisions. This case is one of first impression.

The Elected Delegates Committee in 1947-1948 fiscal year received a total gross of $484,981.44 which consisted of donations of $137.491.45 and Application of Student Minister Training of $347,489.99. The cost of materials, supplies, interest, operating expenses, wages to outside help, etc. to conduct the ministry from which there was related revenue of $347,489.99

was $273,516.23. If there were ordinary business accounting, a substantial part of this $347,489.99 was the product of personal services by the student ministers and it cost the Church $202,347.04 for Student Minister Maintenance for this labor or personal services. Thus by business accounting there was an actual operating loss of about $120,000 if this be viewed as a busines venture, which it was not. It was the laboratory of the theological studies and the ministry of the Church. It was the practice of religion and its promulgation and spreading to all who came in contract with it. The donations of $137,491.45 made by individuals to the Church for its religious purposes made the ministry possible.

The Elected Delegates Committee in 1948-1949 fiscal year received a total gross of $409,590.05 of which $352,528.70 was from Application of Student Minister Training. The actual expenses of this so-called commercial activity but actually student ministery laboratory work and the ministry of the gospel was $219,-252.73 for materials to operate, goods to sell, interest, operating expenses, etc. A substantial part of this related gross income of $352,528.70 was the personal services and labors of the student ministers, which if this were an actual commercial venture would be $187,570.01, the actual cost of Student Minister Maintenance to the Committee. Again, if this were viewed as a busines venture, there was a very large operating net loss. Being a religious activity and any revenue being wholly related to these religious activities, the differential was made up by donations of individuals to the Church for religious purposes.

Now let us view this from the standpoint of the individual members. Mrs. Grassmee in 1948 worked in private employment and received about $2,100 wages. She received for herself from the Church 1/575th part of the $202,347.04 spent on student minister maintenance or about $351. If this were a business venture and she made a transaction where she transferred $1,407 of her wages for $351 for herself and $351 for her mother, she would stand a $705 loss (short term) as she got the support daily and paid currently. Under good accounting practice, she would have a salary to report, and from that deduct her $1,056 loss of her business transaction ($1,407 less $351) and wind up with $1,044 taxable income, if it be viewed as a commercial transaction and as the Commissioner ruled she did not support her mother. If she supported her mother, she had a net taxable income in 1948 of $1395 before two personal exemptions.

Mrs. Grassmee in 1949 earned $1,312 from wages at her private employment. If she made a commercial transaction in which she paid that to the Committee and received a 1/602nd part of the $187,570.01 spent by the Church for Student Minister Maintenance, she would receive $312 in support, and a short term loss of $1,000 as she paid her salary as received and currently received her support daily. If she alone got support, her income tax return would show the $1,312 wages and the short term loss of $1,000 and her net taxable income would be $312 before personal exemptions. If her 84 year old mother were dependent on her, she got twice $312 or $624 which would be her net taxable income subject to two personal exemptions.

The same results would be reached as to Riker who had a six year old daughter. Her net taxable income for 1948 would be $702 before two personal exemptions. For 1949 it would be $624 before exemptions.

But this is not a business venture. It is not an exchange of income for support. The whole relationship is that of parishioner and Church.

The Church Committee filed its return as an exempt organization for 1947-1948 and 1948-1949 fiscal years on Form 990, showing all monies from all sources and how it was spent.

To be doubly safe, the same Church Committee filed its return as an Apostolic Religious Association.

C.

Should the Committee holding the common community treasury report only the Student Minister Training Application, and show only its loss, as gifts are not taxable income, OR should it report all money from all sources including gifts as it has reported them?

(1) If the Committee reported only related income of the Student Minister Training Application, and deducted by good accounting practices its costs therefor, it would deduct not only costs of operations for supplies and power, and rent, but also costs of its labor which is Student Minister Maintenance. This would be a substantial net loss for both 1948 and 1949. The pro-rata share would be a substantial loss instead of income.

(2) If the Committee reported donations along with its related income, and without deducting Student Minister Maintenance there would be a pro-rata net income. However, as the income given to the Church Committee would be reported by it and each member would pay a proportional share of these donations, is the donor of gifts taxable when earned, and again to each member on the same earnings, including the donor?

(3) Would the donor, if the donation is taxable as earned, deduct the religious purpose donation under Section 23(o)?

It can be seen that application of contentions by the Commissioner lead to absurd results:

(a) Mrs. Riker is taxed as her income all funds earned by her group as related income whether the product of the group's services or product of the Church's property.

(b) Mrs. Riker transmitted all of the related income of the group and the Church property with written Church forms that the money must be used for religious purposes. Though taxed as personal income she cannot even deduct the 15% of these funds under Section 23(o) as a religious gift.

(c) Mrs. Riker donated the product of her effort and labor under the partnerships together with the product of the capital and equipment of the Church, partly exhausted in these efforts and earnings. The purpose of these operations is to permit the Church to sell its equipment and salvage its capital investment.

Even this income for religious purposes donated to the Church the Commissioner contends is not subject to 15% deduction of Section 23(o).

(d) Mrs. Riker reported her pro-rata share of the income of the Apostolic Committee, which Apostolic Society returns included both the Group related earnings of $8,959.11 and her donations from the partnership efforts on which the Commissioner sought to impose a tax. She reported two pro-rata shares of $377.39; one for herself and one for her daughter, a total of $754.78. The Commissioner in the deficiency computation, part of the record as an exhibit to the petition before the Tax Court, sought a tax on not only the group's related income to her, and the donation of the partnership efforts but also to tax Mrs. Riker for these *plus* her pro-rata shares of herself and daughter of the Apostolic Society's income which included both these sums of Group related income and her own donations. No 15% deduction was allowed under Section 23(o).

(e) Mrs. Grassmee is sought to be taxed by the Commissioner in her deficiency letter, an exhibit to her petition to the Tax Court, not only for her personal earnings all of which she gave to her Church with a writing stating it was for religious purposes, but also for her pro-rata share of the Apostolic Group which included this very gift she made. She and all of the individuals in the Apostolic Society are taxed on these same earnings as they make up a part of the donations, a substantial part of the Association's income.

(f) Mrs. Grassmee is not even permitted by the Commissioner's contention a Section 23(o) deduction for gifts to her Church for religious purposes, but taxed for earning the money and then on her pro-rata share of all gifts including her own, made to the Church.

(g) Not only is the assessment made seeking to tax Mrs. Grassmee for her earnings given to the Church, but also for *two* distributive shares, one for herself and one for her mother, yet the Commissioner claims she is taxable without taking the personal exemption of the mother.

D.

We think the true rule is:—

Reporting: (1) The Elected Delegates Committee should report *all* money and income from all sources, both donations and related income.

(2) All members, a part of the religious apostolic society should report all monies and income and show how much was given to the Church. Each must report their pro-rata share as a dividend under Subdivision 18 of Section 101 of the net income, including gifts reported by the Church Committee.

(3) All in the apostolic religious society should report by family groups. Babies in arms and old persons 84 years old need not make individual returns under penalty of losing their individual exemption. The extra work of the taxing office and the individuals

does not require this mass of individual detail involved in so many returns. The custom of returns by family units, with each pro-rata share of each person in the group should be sufficient. It works with those outside the religious apostolic society. It should work within the group. In view of the common sense and customs and rules as to personal income tax returns and the work any other practice would involve, the reporting by family group of both income and exemptions for children and old folks (84-5 years old) would seem the proper course.

Taxing: (1) The Church Committee is exempt under Subdivision 6 and Subdivision 18 of Section 101. As such it is not taxable.

(2) The individual who earns any sum and keeps it and does not donate it to her Church is taxable as income. This involves no problem.

(3) Those who give anything to their church should be entitled to the Subdivision 23 (o) deduction on such gifts. Such earnings would be taxable, after that deduction, to the individual earning it.

(4) If the Court determines the pro-rata share of those in the Apostolic Religious Association should be computed on *all* sources of revenue, both related income and donations, then the various individuals would report their wages, deducting actual gifts therefrom to their Church and *all* in the apostolic religious corporation would report as part of their income their pro-rata share of donations received by the Church. The donor would then deduct gifts actu-

ally made from earnings and include his pro-rata shares of the members. Otherwise, those earnings would be taxed twice.

(5) If the Court determines the pro-rata share of those in the apostolic religious corporation should not include the donations, the pro-rata share would be reported by the family group and taxed as income. The donor would be taxed on income including that given to the Church, less the 15% Subdivision 23 (o) deduction.

(6) In no event would an official of the Church be taxed as an individual for money earned by the Group's efforts in their ministry or for the return on capital invested by the Church in the facility or for exhaustion of Church property (depreciation) used to earn that related income of the ministry of the Church. Arithmetical mistakes or failure to include costs of supplies consumed in earning that related income, should in no event be the basis of any personal tax liability of the spiritual instructor of the local group, such as Mrs. Riker.

IV.

A CHURCH UNDER CALIFORNIA LAW HOLDS ITS PROPERTY IN TRUST FOR THE SPIRITUAL BODY WHICH IS ALL IMPORTANT AND A CHURCH CORPORATION OR TRUSTEES ARE WHOLLY SUBSERVIENT.

The Tax Court opinion assumes that since the temporal agency was holding property under trust for the religious uses of the spiritual body and was sub-

servient thereto, the temporal agency was taxable and not an exempt organization. This was because of the particular religious beliefs of the spiritual body that it taught Christianity by application to everyday activities by having the public witness these applications of these teachings.

The leading case of *Watson v. Jones,* 80 U.S. (13 Wall.) 679, 20 L. Ed. 666, holds a religious society's property is held in trust for the doctrines of the Church.

The leading case in California as to religious societies and their property is *Wheelock v. First Presbyterian Church,* 119 Cal. 477, 51 P. 841: This decision involved the dissolution of a church corporation and the division of the church to two separate organizations by the principal organization of the Church. The Court held that the spiritual or ecclesiastical body of the Church was all important, and that the Church corporation was a mere convenience to assist in the conduct of the temporal part of the Church, that notwithstanding the incorporation, the ecclesiastical body is still all important and the corporation is a subservient factor. The Supreme Court, in that decision went on to hold that a religious corporation is something peculiar unto itself, and that its function is to stand in the capacity of an agent holding title to property, with power to manage and control the property in accordance with the spiritual ends of the Church. The Supreme Court, in that case, held that the incorporation did not change the ecclesiastical status of the congregation, but only afforded

a more advantageous civil status; that the directors or trustees of the Church corporation have no authority over church affairs which rests with the ecclesiastical body. The Court held that property standing in the name of a Church corporation is held in trust for use of the Church proper, and the trustees hold the property for the use and enjoyment of the Church, and every member in it is a beneficiary of that trust. The Court held that the Church corporation held under a trust as completely as if the trust were declared by deed, and such a trust is not distinguishable from other trusts over which the court of equity have general supervisory powers.

The California Supreme Court in *Baker v. Ducker,* 79 Cal. 365, 21 Pac. 763, held that the property acquired by a religious society was held under a trust by the Church corporation, and a parsonage obtained by contributions could not be diverted to other uses by a majority of the membership. The case of *Bomar v. Mount Olive Missionary Baptist Church,* 92 Cal. App. 618, 286 Pac. 665, followed the doctrine of *Wheelock v. First Presbyterian Church,* 119 Cal. 477, and held that the ecclesiastical body was all important, and the corporation a subservient factor in the life and purposes of the church; and that the corporation was a mere agent or instrument for holding title to property and managing the temporal affairs.

Many churches, as does this Church of Christ's Church of The Golden Rule, divide the powers and authority. Spiritual matters are often conducted by an organization or Church Session. Property and

matters secular are often handled by trustees, a non-profit corporation with directors or trustees or a corporation sole. The spiritual body or Church government is all important. It deals with doctrines, teachings, Church practices and services. The property or secular matters are conducted by a temporal agency or trustees, incorporated or unincorporated, who deal with the money and property, pay ministers, sextons, support religious training. They hold as trustees under a religious trust for the spiritual organization.

The cases hold that as to religious matters, the determination of the highest authority in the Church are conclusive in the Courts.

Gonzales v. Roman Catholic Church, 280 U.S. 1, 50 S.Ct. 5, 74 L. Ed. 131;

Permanent Committee v. Pac. Synod of Presbyterian Churches, 157 Cal. 105, 106 P. 395.

Under our concepts of freedom of religion we leave matters wholly ecclesiastical to the Church such as who is qualified to be a chaplain of a parish, who is qualified by religious beliefs to admission into Church membership, matters of discipline, faith and ecclesiastical rule. Courts under our Constitution cannot sit as ecclesiastical tribunals to try questions of religious belief or faith. When such questions arise, the Courts deal only with property. Matters ecclesiastical are determined by ecclesiastical officials or Church governments or authorities. The Court must accept their determinations and conclusions and then apply them to the property rights in dispute. This is true though the ecclesiastical matters which the Court must fol-

low the particular Church government's determination effects the property rights at issue.

In *Permanent Com. of Missions v. Pacific S. Presbyterian Church,* 157 Cal. 105 it was held:

> "Lest we be understood to hold that the civil courts can disregard and overrule the decisions of the church authorities, acting regularly, in ecclesiastical matters, we expressly disavow that doctrine. We approve the principle laid down by the Supreme Court of the United States in *Watson v. Jones,* 80 U.S. 726, and by the Supreme Court of this state in *Horsman v. Allen,* 129 Cal. 136, relating to this subject. 'Whenever the questions of discipline, or of faith, or ecclesiastical rule, custom, or law have been decided by the highest of the church judiciatories to which the matter has been carried, the legal tribunals must accept such decisions as final, and as binding on them, in their application to the case before them.' *Watson v. Jones,* supra, 80 U.S. 727, 20 L. Ed. 666. This was said with reference to the Presbyterian Church, and it is declared to be the doctrine applicable to all churches having a similar system of ecclesiastical government. The doctrine has been followed in many other cases and, although not accepted in England, it is the prevailing rule in this country."

It is clear that because a Church follows the law of California and its spiritual body is governed by a spiritual organization and its property is held and managed by a Committee who holds that property in trust for religious purposes and is subservient to and

holds property and acts for the spiritual body, it is nevertheless an exempt organization in law, Section 101, Sub. 6. That the spiritual body may in its determination of ecclesiastical matters believe Christianity should be lived and it should be spread and taught by applying these teachings to everyday life so the public can witness them is hardly grounds for imposing a tax Congress did not intend.

These are matters of individual religious beliefs which one may or may not hold and if one holds them and joins a Church with similar beliefs Congress did not intend to tax one for one's religious beliefs as it results in the Riker and Grassmee cases.

CONCLUSIONS.

1. The donations by the appellant taxpayers to their Church with written statement accompanying each donation that the money was for religious purposes of the Church, were subject to the deduction of Section 23(o) as a gift to a religious organization. It also was a gift for the use of the religious purpose and created a fund or trust within Section 23(o).

2. The Elected Delegates Committee is an exempt organization within Section 101, Subdivision 6, as an organization exclusively organized and operated for religious purposes, no part of the income inuring to the benefit of any individual and no part of its activities being for propaganda or to otherwise influence legislation.

3. The fact the particular Church used so-called commercial activities as a laboratory for its student minister training and to carry the ministry of its teachings of Christianity to the public to show and illustrate that these teachings could be successfully applied to everyday life does not make it the less exempt.

a. The Church Constitution and Canon Laws require all money and property to be used solely and exclusively for religious purposes and contain many effective guaranties. The Church Committee accepted donations only with the written statement the money was for religious purposes.

b. The primary and sole purpose of the Church activities were religious. The so-called commercial activities were but a means to this religious purpose. It was merely incidental thereto. It was connected with and related to the religious purpose. The student ministers in these Church activities and ministry served without pay or compensation to carry out these religious purposes, religious training and their ministry.

4. Those in the full time work of this Church had the bare necessities provided them and their families to permit their full time study and work in their religious crusade. They lived in a religious apostolic society. Those who gave of their earnings to the Church's religious purposes are entitled to a Section 23(o) deduction. The common community treasury (Section 101, Sub. 18) organization filed it returns in the fiscal years involved as required by the regula-

tions and showed all their receipts, both the related income of Student Minister Training Application and donations from individuals. The members of this religious apostolic society each filed their income tax returns showing all monies passing through their hands and their pro-rata share of the apostolic society's income.

a. An officer or official of a local group who conducts a student minister training center and remits all related income to the Church should not be taxable upon these receipts as individual income. The arithmetical mistakes and omission of expenses of the related income and reimbursed by the Church Committee should not increase this net earnings of the group and increase the personal tax of this official.

b. When all members report their pro-rata share of the apostolic society's income, including gifts and are taxed thereon as a dividend, the donations included in this income should not be taxed both to the donor and to the members included in their pro-rata share upon the same money.

c. Members of an apostolic society should follow the customs and practices and regulations applicable to all others. They should report by family units and small children and old persons (aged 84 or 85) need not file separate returns upon penalty of losing their personal exemptions. The family group should return a separate dividend under Sub. 18 for each member.

The particular law applicable to Subdivision 18 of Section 101 is important as this is a test case for many

in the group and the decision will govern a number of pending matters (R. p. 74-76). It is a case of first impression.

Dated, San Francisco, California,
September 14, 1956.

HOWARD B. CRITTENDEN, JR.,
Attorney for Appellants.

No. 15072

IN THE

United States Court of Appeals For the Ninth Circuit

PEGGY LOU RIKER and FREDA H. GRASSMEE, *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Petition for Review of the Decision of the Tax Court of the United States

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BRIEF FOR THE RESPONDENT

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OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 80-96) are not officially reported.

JURISDICTION

The petition for review (R. 98-100) involves deficiencies in income taxes for the taxable years 1948 and 1949 in the amounts of $84.80 and $25.50, respectively, determined to be due and owing by taxpayer Grassmee; and in the amount of $1,404.68 for the taxable year 1948 determined to be due and owing by

taxpayer Riker. Deficiency notices were sent to taxpayers on November 25, 1952. (R. 9, 12, 13, 76.) Taxpayers filed petitions for redetermination with the Tax Court on February 19, 1953 (R. 3, 6), under the provisions of Section 272 of the Internal Revenue Code of 1939. The decisions of the Tax Court were entered on December 15, 1955, and served on December 16, 1955. (R. 96-98.) These consolidated cases are brought to this Court by a petition for review filed January 16, 1956. (R. 98-100.) The jurisdiction of this Court is invoked under the provisions of Section 7482 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

1. Whether income derived from the operation of a restaurant by taxpayer Peggy Lou Riker was income taxable to her or to a religious organization of which she was a member.

2. Whether Christ's Church of The Golden Rule, which was authorized to and did conduct business for profit through its principal temporal agency, the Elected Delegates Committee, was a corporation "organized and operated exclusively for religious * * * purposes, * * * no part of the net earnings of which inures to the benefit of any private shareholder or individual" within the meaning of Section 23(o)(2) of the Internal Revenue Code of 1939 so that contributions or gifts thereto were deductible for income tax purposes.

3. Whether taxpayer Grassmee was entitled to dependency credits for her mother in the taxable years

1948 and 1949 under Section 25 (b)(1)(D) and (3) of the Internal Revenue Code of 1939.

STATUTE AND REGULATIONS INVOLVED

These are set forth in the Appendix, *infra.*

STATEMENT

The findings of the Tax Court (R. 81-88) may be stated as follows:

During the taxable years 1948 and 1949, taxpayers, Peggy Lou Riker and Freda H. Grassmee, were members of Christ's Church of The Golden Rule (hereinafter referred to as the Church), a religious nonprofit California corporation, which was organized in 1944. (R. 81, 84, 87.) The Church was adjudicated a bankrupt in 1945 and during 1948 and 1949 was in bankruptcy. (R. 81.)

The Church adopted a constitution (R. 20-30) and canon laws (R. 30-67) in 1948. According to its constitution (R. 22, 81-82), the economy of the Church is based upon a belief that economic equality is the only enduring foundation upon which to build industrial, business, political, national, and international relations; and that to insure such equality (R. 22)—

> the property and earnings of the individual members of the Church should be owned and managed by the Church for the benefit of all mankind in accordance with the rules and regulations of the ecclesiastical society of this Church, that God may be glorified and all mankind directly or indirectly benefited.

The ecclesiastical affairs of the Church are in the hands of an organization consisting of a Senior Elder, an Advisory Board of Elders, and College of Pastors. (R. 23-26, 82.)

The temporal affairs of the Church are in the hands of "temporal agencies," subject to the ultimate control of the ecclesiastical authorities. Such affairs are carried on through charters granted by the Senior Elder, with the advice of the Advisory Board, "to the various congregations, projects and other temporal activities." (R. 26-27, 82.)

According to the canon laws of the Church, a charter could be granted, withheld, or revoked upon whatever terms and conditions the Church government designated. Those laws provided (R. 33, 38, 82), *inter alia,* that all temporal agencies "shall hold their property upon a private trust for the ecclesiastical organization," and that (R. 38)—

> All transfers, conveyances and sales shall be presumed to be bona fide gifts to the Lord's work unless there be conditions or understandings or promises to the contrary in writing duly approved in writing by the duly constituted ecclesiastical Church Government.

In operation, activities of Church members are of two types. Some members devote all of their time to working in Church projects and studying to be ministers of the Church's teachings. These are called student ministers, and they live in apostolic societies called "Student Minister Training Projects." One purpose of these projects, most of which were engaged

in commercial activities, is to spread the teachings of the Church by having the public witness the application of these teachings in everyday life. Some projects were not engaged in commercial activities but simply operated residential facilities for Church members. Members living in both types of projects contributed their earnings to the Church. Other Church members lived at home and participated in Church activities. The Church operated a theological seminary. (R. 48, 82-83.)

The principal temporal agency of the Church is the Elected Delegates Committee (hereafter called the Committee) which was formed in 1946. (R. 83.)

During 1948 and 1949 the Committee operated various student minister training projects. It also operated the Church treasury and carried on various commercial activities in competition with privately owned enterprises, including, among others, a restaurant, a laundry, a lumber yard, bulb gardens, farming, stock raising, and a warehouse. These enterprises were operated for profit. Gross receipts from the operation of these projects were sent to the Committee, covered by a form stating that the transfer was an outright gift from the project manager and was to be used only for Church purposes. (R. 83.)

For 1948 and 1949 the Committee filed amended returns of income on Treasury Department Form 990 as an organization exempt under Section 101 of the Internal Revenue Code of 1939, and also amended returns as an apostolic society on the partnership Form 1065. The returns showed the Committee's gross income for 1948 as $484,981.44, of which $347,489.99

was reported as received from the operation of student minister training projects, and $137,491.45 from contributions and gifts. In 1949, gross income of $409,590.05 was reported, of which $352,528.70 was from the operation of student minister training projects, and $56,033.27 was from gifts and contributions. On the Committee's returns as an apostolic society, the undistributed pro rata share of each member of the apostolic society was reported as $342.27 for 1948 and $316.17 for 1949. (R. 83-84.)

Prior to joining the Church, Peggy Lou and her husband had operated a drug store in partnership with his parents. The partnership was dissolved and Peggy Lou and her husband took the fixtures of the business and made a cash settlement with his parents. The fixtures were then used to set up a student minister training project to operate a restaurant under the name of "Your Food Fountain" (hereafter sometimes called the Fountain). Peggy Lou was manager of the project and the business license was in her name. Her duties included giving religious instruction to "members" of the project, who varied in number from 12 to 17. All of the receipts from the operation of the Fountain were turned over to the Committee on a form such as that described above, signed by Peggy Lou as project manager. Funds were in turn allocated by the Committee from the Church treasury for the operation of the Fountain and the living expenses of the members of the group. (R. 84-85.)

While the bankruptcy proceedings of the Church were pending, Peggy Lou sued the trustees in bankruptcy to establish her ownership of the equipment

of the Fountain. An agreement (Pet. Ex. 9) was made in May 1947, between Peggy Lou and the trustees relating to the Fountain while the litigation was pending, which provided that Peggy Lou was to operate the establishment until the lawsuit involving ownership was settled. The income during this period was to belong to Peggy Lou and she was to pay the trustees certain amounts to be deposited by the trustees in a trust fund account. All operating expenses were to be paid by Peggy Lou. (R. 85.)

From May 1947 until July 1948, the restaurant was operated under this agreement. Of this period, from May 1947 until January 1948, the restaurant was run as a "Church project," and the earnings were turned over to the Committee by Peggy Lou. From January 1948 until June 1948, Peggy Lou ran the business in private partnership with other persons who were not members of the Church, and from June until September 1948, she operated the business on a percentage basis with a prospective purchaser of the business. Her partnership share of the restaurant's earnings was contributed to the Committee. For five months of her fiscal year 1948, January 20 to June 30, Peggy Lou filed partnership returns for three different partnerships that operated the restaurant in this period. In July 1948, the assets of the restaurant were sold to the Committee for $1,500. Peggy Lou consented to the sale. (R. 85-86.)

Peggy Lou filed an income tax return for her fiscal year 1948 (October 1, 1947, until September 30, 1948), which disclosed a net profit of $7,568.25 from the operation of a restaurant business under the name of

"Your Food Fountain." (R. 86.) A memorandum attached to the return reads as follows (R. 86-87):

> ITEM 2. WAGES, ETC.
>
> Taxpayer was employed by Own Business for a gross income of $8959.11 during the taxable year. However, under the rules of the apostolic society (of which taxpayer is an associate) that all in the society share their income, $8959.11 was contributed to and became a part of the income of the apostolic society, and is reported as part thereof. Taxpayer would therefore, be taxed twice on the same income by reporting it as wages and also as a dividend. For this reason, this latter sum is reported only as part of the dividend or taxpayer's pro rata share of the net income of said apostolic religious society. (See Item #3 Dividends).
>
> ITEM 3. DIVIDENDS
>
> 1/575 interest in $217,001.54 net income of The Elected Delegates' Committee of The Ecclesiastical Society of CHRIST'S CHURCH OF THE GOLDEN RULE, an Apostolic Religious Association, for its accounting period of Oct. 1, 1947 to Oct. 1, 1948. This was not received as a dividend, but is reported under Sec. 101(18)—Per person in Association $377.39
>
> Number of persons in taxpayer's family who were in association and obtained support from Society during period:
>
> 2 times $377.39 ..... $754.78

In her return for 1948, Peggy Lou claimed the sum of $8,959.11 as a deductible contribution to the Church.

This claim was disallowed by the Commissioner and this Action was alleged as error in the original petition. In an amended petition, it was prayed that the income of the Fountain be found to be the income of the Church. (R. 87.)

Freda H. Grassmee was employed in a law office in Los Angeles during 1948 and 1949, and contributed practically all of her salary for those years to the Committee. She and her mother lived in a Church residential project and participated in religious activities of the Church. Both received their support from the Church. Freda's income tax returns for 1948 and 1949 contained memoranda as to the disposition of her income similar to that attached to Peggy Lou's return. On her returns for both years, she claimed a dependency exemption for her mother. (R. 87.)

The Commissioner disallowed the deductions claimed as contributions to the Church in 1948 and 1949. In an amended answer, he claimed increased deficiencies based on disallowance of the dependency credits claimed for Freda's mother. (R. 88.)

The Tax Court sustained the Commissioner's determinations and held (1) that the income derived from the operation of the Fountain by Peggy Lou was her income and not that of the Church organization to which she contributed it (R. 88-89); (2) that no part of the amounts contributed to the Church by the taxpayers was deductible as a contribution to a religious organization since the Church was not organized and operated exclusively for religious purposes within the meaning of Section 23(o) of the Internal Revenue Code of 1939 (R. 91-95); and (3) that taxpayer Freda

H. Grassmee was not entitled to a dependency exemption for her mother since her support was received from the Church. (R. 96.)

SUMMARY OF ARGUMENT

Taxpayers were members of a church group, which, insofar as the record discloses, had no church buildings and engaged in no activities of a purely spiritual nature, as commonly understood. It did, however, engage in various commercial enterprises under the title of "Student Minister Training Projects." In addition to the production of income, the purpose of these projects was alleged to be to permit the public to witness the application of the Church's precepts to everyday life. Just how these precepts were applied or how the conduct of these business enterprises differed from an admitted commercial activity is not explained or discernible.

During the taxable period, taxpayer Riker operated a restaurant and taxpayer Grassmee was employed in a law office. Both lived in Church housing projects, contributed their earnings to the Church, and then received a so-called dividend or pro rata share of the net income of the Church, or more specifically of the Committee, the principal temporal agency of the Church. Both claimed that their contributions were deductible in part under Section 23(o)(2) of the Internal Revenue Code of 1939. In addition, taxpayer Riker contended alternatively that she operated the restaurant as a Church project and, hence, that the income from its operation belonged to the Church and not to her.

During the taxable period, the Church was in bankruptcy. According to the Tax Court's findings, taxpayer Riker operated the restaurant during this period in part as a Church project under an agreement with the trustees in bankruptcy whereby the income therefrom belonged to her, and in part as a private business enterprise. It concluded, therefore, that the restaurant income belonged to taxpayer Riker, rather than to the Committee, and was taxable to her, as the one who had earned it. We submit, however, that the evidence fails to support the finding that the restaurant was ever operated as a Church project or that it was an asset of the bankrupt estate, and hence that under no circumstances can it be said that any part of the income from its operation belonged to the Church or the Committee rather than taxpayer Riker. Neither does the evidence support the contention, nor do taxpayers demonstrate, that the Committee, or the entire Church organization, qualifies as a religious or apostolic association or corporation under Code Section 101(18), so as to constitute the income, from the various commercial activities, income of the Committee, rather than of the members of the Church.

It is also clear that neither the Church, i.e., the "ecclesiastical society," nor the Committee, its principal temporal agency, qualified as an organization "organized and operated exclusively for * * * religious * * * purposes" within the meaning of either Section 23(o)(2) or 101(6) of the Code. In fact, the evidence does not warrant any distinction between these two facets of the Church's operations, for both were under the complete domination and control of the Senior

Elder. The Committee was merely an agency of the ecclesiastical society of the Church for carrying out its temporal functions, and hence its commercial activities must be ascribed to the latter, or more properly to the Church itself. Even if such a distinction be assumed and the ecclesiastical society be accepted as a qualified religious organization within the meaning of Sections 23(o)(2) and 101(6), it is clear that the Committee did not so qualify, and that under decisions of this Court the so-called "ultimate distinction" test cannot be applied by analogy so as to render contributions to the Committee for the use of the ecclesiastical society of the Church deductible for tax purposes.

Taxpayer Grassmee has also failed to sustain her burden of proof in support of her claim that she was entitled to a dependency credit for her mother.

ARGUMENT

I

THE INCOME FROM THE OPERATION OF THE RESTAURANT WAS TAXABLE TO TAXPAYER PEGGY LOU RIKER

A. Preliminary

In her original petition to the Tax Court (R. 13-16), taxpayer Peggy Lou Riker alleged that her income from all sources for the year ending September 30, 1948, was $8,595.11, that she made a gift thereof during that taxable period to Christ's Church of The Golden Rule, an alleged tax exempt organization under Section 101(6) of the Internal Revenue Code of 1939, Appendix, *infra,* and prayed, *inter alia,*[1] that

[1] She also prayed that certain property and sales taxes in the amount of $168.61 be allowed as proper deductions, and that the Tax Court determine her income to be $8,959.11, rather than

"the donations to said Church be properly allowed as deductions for religious purposes" (R. 16). In an amended petition (R. 68-74), she alleged that her income from all sources for the period in question "was the sum of $377.39 per person, herself, and her minor child residing with her, being an undivided 1/575 interest in the net income of the Apostolic Society" (R. 68); that she reported such income as $754.78; and that "said income is a proportionate share of the gross receipts, including gifts, to the Common Community Treasury of the Apostolic Society of Christ's Church of the Golden Rule" (R. 68-69). Whereupon, she prayed further that the Tax Court determine that "the funds of Your Food Fountain are properly income of the said committee of said Church, and that your taxpayer is taxable under the provision of Subdivision 18, Section 101 of the Revenue Code, only for her proportionate share, whether received or not, for herself and her minor child, after deduction of personal exemptions of the taxpayer and her minor child therefrom." (R. 74.) In his answer, the Commissioner denied these allegations. (R. 76-77.)

The pleadings thus raise three issues: (1) Whether the income from the operation of the restaurant, Your Food Fountain, was that of taxpayer Riker or the Church of which she was a member; (2) if the income of the taxpayer, whether the Church qualified as a religious organization under Section 23(o)(2) of the Internal Revenue Code of 1939, Appendix, *infra,* so as

$9,713.89, as corrected by the Commissioner. In his deficiency notice, the Commissioner stated that, inasmuch as the standard deduction had been claimed, the deduction claimed for taxes had been included in computing her adjusted gross income. (R. 16, 19.)

to entitle taxpayer to a 15 per cent deduction with respect to the contributions she made to it during the taxable year 1948; and, alternatively, (3) whether the Church qualified as a religious or apostolic association or corporation under Section 101(18) of the Internal Revenue Code of 1939, Appendix, *infra,* so that taxpayer, as a member thereof, was taxable only on her pro rata share of the net income of such association or corporation.

B. The Income From the Operation of Your Food Fountain Was That of Taxpayer Riker and Not That of Either the Church or Its Principal Temporal Agency, the Committee

In holding that the income from the operation of the Fountain during the taxable period October 1, 1947, to September 30, 1948, belonged to taxpayer, the Tax Court recognized (R. 89) three distinct phases of operation during that period: (1) October 1947 to January 1948, when she ran the restaurant "as a Church project"; (2) January to June 1948, when the restaurant was run as a private business (not as a Church project) by a partnership of which she was a member; and (3) July to September, 1948, when she operated the business on a "percentage basis" with another person who was interested in buying the property.

With respect to the first two phases, the Tax Court held (R. 89-90), that, "at least" during that period (October 1, 1947, to June 30, 1948), Peggy Lou operated the restaurant under an agreement with the trustee in bankruptcy; that according to the agreement she had an unqualified right to receive the funds from its operation; that her testimony was that she did receive the funds; and, therefore, that the income

she received from its operation was hers "and not the Committee's."

It is a fundamental assumption of the Tax Court's decision that the restaurant business known as Your Food Fountain was an asset of the bankrupt Church. Section 70 of the Bankruptcy Act, c. 541, 30 Stat. 544 (11 U.S.C. 1952 ed., Sec. 110), vests the trustee, by operation of law, only with such title as the bankrupt organization had prior to its adjudication. *Zartman* v. *First National Bank,* 216 U.S. 134; *Schultz* v. *England,* 106 F. 2d 764 (C.A. 9th); *In re Pagliaro,* 99 F. Supp. 548 (N.D. Cal.), affirmed *per curiam, sub nom. Costello* v. *Golden,* 196 F. 2d 1017 (C.A. 9th). Property to which the bankrupt has no ownership right does not become a part of the bankrupt's estate. *In re Goldsby,* 51 F. Supp. 849 (S.D. Fla.). If, therefore, the Church had no title to the business or right to the income therefrom at the time (1945) of its adjudication as a bankrupt, the entire income belonged to Peggy Lou, as the owner and operator of the business, and was taxable to her; and the trustee had no right to enter into the above-mentioned agreement which formed the basis of the Tax Court's decision. Insofar as disclosed by the record, the facts are as follows:

The Church, as found by the Tax Court, was adjudicated a bankrupt in 1945 and continued in a status of bankruptcy during 1948 and 1949. (R. 81.) During the pendency of those proceedings, according to the Tax Court's finding (R. 85), Peggy Lou sued the trustees in bankruptcy to establish her ownership of the "equipment" of the Fountain.

Although the Tax Court visualized that suit as one to determine ownership of the restaurant "equipment" and as bearing on the right to the income in question (R. 85, 88, 90), we think it was in error in so doing, for we submit that ownership of the "equipment" as opposed to ownership of the business could not serve as a basis for determining the right to the income from the operation of the business. Petitioners' Exhibit 9, which is the only evidence of record concerning the nature of Peggy Lou's suit against the trustees, consists of (1) a copy of a "Petition for Authority to Execute Operation Agreement Re Your Food Fountain and for Approval of Said Agreement" to which is attached a copy of the agreement in letter form, and (2) a copy of an order signed by the Referee in Bankruptcy authorizing execution of the agreement. The petition recites that "litigation is now pending for the determination of the ownership of Your Food Fountain," and that "to the end that provisions may be made for the operation of said cafe in order that its good will may be preserved during the pendency of the said litigation," the trustees and Peggy Lou had negotiated the proposed agreement. The order authorizing the execution of the agreement described it as providing "for the operation of the business known as Your Food Fountain * * * during the pendency of the litigation now pending to determine the ownership thereof." It appears, then, that the nature of Peggy Lou's suit was one to determine the ownership of the business rather than merely of the "equipment" used therein.

Other facts of record tend to indicate that Peggy Lou rather than the Church did own the business, as well as the equipment and property. Thus, according to her testimony (R. 115-116, 144), she and her husband purchased property at San Bernardino, California, and with "fixtures" acquired from a former business established Your Food Fountain as a student minister training project. The business license, moreover, was carried in Peggy Lou's name as an individual. (R. 145.)

There is no evidence of record that prior to the bankruptcy proceedings Peggy Lou ever transferred or conveyed either title to the business or its assets to the Church. Neither is there any evidence that Peggy Lou, as an individual, or the group or project of which she was leader, was ever chartered as a "temporal agency"[2] of the Church so that it could be said that under the constitution and canon laws of the Church (R. 27-28, 33) the restaurant or its assets were held "in trust for the benefit of the ecclesiastical society of this Church."[3]

Other than the irrelevant fact that the physical assets of the restaurant business were sold with the

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[2] A "temporal agency" is defined in the canon laws as (R. 34-35) —any person, natural or artificial, or group or entity who acts in any way in matters temporal or secular for the ecclesiastical Church Government or religious society or any part thereof or any project, congregation or activity of the Church or who holds any property subject to any religious trust or use or purpose under the doctrines, teachings or beliefs of the religious society or ecclesiastical Church Government.

[3] It is noted that whereas the Constitution speaks of a temporal agency holding in trust "property of the Church" to which it has title or possession (R. 27-28), the canon laws provide that such agencies shall hold in trust "their property" (R. 33).

approval of Peggy Lou to the Committee (the principal temporal agency of the Church (R. 83)) in July 1948, and the further fact that the proceeds from the "sale of the restaurant" in late 1948 or early 1949 went to the Committee and not to Peggy Lou (R. 86, 90), the record discloses no determination as to ownership of the restaurant business. In the absence of any such determination and under the facts of record, it does not appear that the business was an asset of the estate of the bankrupt Church which the trustees had any right to deal with, and hence to declare that Peggy Lou should operate the business and be entitled to the income from its operation. The fact of the matter appears to be that Peggy Lou, and not the Church or the trustees in bankruptcy, owned the business and was entitled to the income therefrom in her own right.

Even assuming that the trustees rightfully dealt with the restaurant as an asset of the bankrupt estate, the income in question belonged, as the Tax Court held, to Peggy Lou and not to the Church. Under the terms of the agreement, executed in May 1947, Peggy Lou was to operate the restaurant until the question of ownership was settled. The agreement provided that "All funds derived from the operation of the cafe under this arrangement shall belong to you"; that she was to pay all operating expenses, as well as the payments "covering the incumbrance now on the real property known as Green Acres Ranch"; and that she was to pay specified sums to the trustees monthly to be deposited in a trust fund account, which payments were (1) to cover depreciation of

assets of the business while in her possession, and (2) to constitute payment by her in purchase of the inventory value of food and supplies of the value of $483.04. It was further provided that, in the event that it was finally adjudicated that Peggy Lou had no interest in either the realty or personality of the business, the money paid into the trust fund account was to pass absolutely to the trustees as a part of the bankrupt estate, but that otherwise, it was to be disposed of in accordance with the decision "as to the ownership of the business." (R. 85, 89; Pet. Ex. 9.)

On the basis of its findings (R. 85), the Tax Court held (R. 88-89), that Peggy Lou operated the restaurant under the agreement until July 1948, when the restaurant "equipment" was sold to the Committee.[4] It further held (R. 85, 89) that "According to her testimony," she, as the project manager, ran the restaurant "as a Church project"[5] during that

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[4] On July 22, 1948, the trustees filed a petition for approval of the sale of the "physical assets" of the Fountain which recited in part that the Committee had offered to purchase the assets thereof for the sum of $1,500, that the sum of $4,455.09 held by the trustees in the trust fund account was to be released to the bankrupt estate free and clear of any and all claims, but that "the balance" of the litigation involving Peggy Lou and her husband was not to be affected by the sale. On July 22, 1948, the Referee in Bankruptcy entered an order authorizing and directing the trustees "to deliver an executed Bill of Sale on * * * Your Food Fountain, * * * said Bill of Sale to cover all right, title and interest of the within estate in and to the items set forth in Exhibit 'A' and 'B' attached to the aforesaid petition." (R. 130; Pet. Ex. 10.) (The exhibits referred to are not part of Petitioners' Exhibit 10.)

[5] According to the testimony, Peggy Lou and her husband purchased property at San Bernardino, California, and with "fixtures" acquired from a former business established Your Food

part of her fiscal year extending from October 1947 to January 1948,[6] but that from January to June 1948 the restaurant was run as "private business" (not as a Church project) by a partnership of which she was a member.[7]

The Tax Court concluded that during the period from October 1947 to January 1948 Peggy Lou turned over the gross receipts of the business to the Committee "as a gift" (R. 85, 89, 144-145) and that "in the same manner" she turned over her share ($1,390.86) of the proceeds of the business in the January-June (partnership) period. In arriving at this conclusion, the Tax Court said (R. 89-90) that from the evidence it was clear that during the "October to July period" Peggy Lou "operated the restaurant under the agreement with the trustees in bankruptcy and the income she received from its operation was here and not the Committee's"; that the income was earned principally as a result of her efforts in operating the restaurant; that according to the agreement with the trustees she had an unqualified right to receive the funds from its operation; and that she actually did receive them. In support of its con-

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Fountain as a student minister training project. (R. 115-116, 144.) The number in the group was between 12 and 17. (R. 146.)

[6] Mrs. Huff, secretary to the Elected Delegates Committee, who was also a member of that Committee and a student minister of the Church, testified that the restaurant Your Food Fountain was operated as a student minister training project of the Church and that the proceeds (gross receipts) from that activity were "released" by taxpayer Riker "as the operator of that activity," to the Committee "up to January of 1948." (R. 102, 114-117.) Peggy Lou testified to the same effect. (R. 144-145.)

[7] See testimony at pages 149-150 of the record.

clusion, the Tax Court cited *Helvering* v. *Horst,* 311 U.S. 112, to the effect that income is taxable to the one who earns it or otherwise creates the right to receive it and enjoy the benefit of it when paid, and pointed out (R. 90) that the fact that her enjoyment of the income consisted of donating it to the Committee could not relieve her of the liability for tax on its receipt.

With respect to the income received during the third phase of the operation of the business, namely, from July to September 1948, the Tax Court held (R. 90) that Peggy Lou had failed to sustain her burden of overcoming the presumptive correctness of the Commissioner's determination that the amount (unknown) of income received was hers. As a matter of fact, and apart from the presumption, Peggy Lou's own testimony (R. 151) was that during this third phase she conducted the business "on a percentage basis" with a prospective buyer and turned over her share of the money from that operation to the Committee, thus establishing, as the Tax Court previously concluded (R. 89), that she had made a gift thereof to the Committee. Although the Tax Court seemed to think (R. 90) that "evidence" that the Committee owned the restaurant "equipment" during this period and that the proceeds from the "sale of the restaurant" late in 1948 or early in 1949 went to the Committee (R. 130)[8] tended "to meet this burden,"

[8] Mrs. Huff testified (R. 130) that when Your Food Fountain was eventually sold in 1949, the "main treasury of the church, the Elected Delegates Committee accountability," not Mrs. Riker, received the proceeds.

we submit, as previously pointed out, that ownership of the "equipment" is irrelevant to a determination of who had a right to the restaurant income, and that the evidence as to whether the Committee purchased the business or only its physical assets in July 1948, and ultimately sold the business or the assets, is so vague and confusing, that it cannot possibly serve "to meet" the burden of proof or establish that the income belonged to the Committee rather than Peggy Lou.

Taxpayers insist, however, that the "organization," apparently referring to the Committee (Br. 51, 58), is exempt under the provisions of Section 101(18) of the Code. Although they do not expressly say so, taxpayers' apparent purpose in advancing this contention is to establish that they had no individual taxable income other than that allegedly received during the taxable years as their pro rata share of the net income of the Committee. No reasons which are even remotely convincing have been offered in support of this contention. As demonstrated above, and found by the Tax Court, the income from the operation of the restaurant belonged to taxpayer Peggy Lou Riker and was taxable to her. Patently, the salary received by taxpayer Grassmee from private employment was also her income and not that of the Committee or the Church.

Section 101(18) was apparently designed to apply only to organizations whose members lived a communal religious life. It provides for the exemption from taxation of "Religious or apostolic associations or

corporations'' if (1) such associations or corporations have a common or community treasury, and (2) even though they engage in business for the ''common benefit'' of their members, but (3) only if the members include (at the time of filing their returns) in their gross income their pro rata shares, whether distributed or not, of the net income of the association or corporation for such year. Any amount so included in the gross income of a member is to be treated as a dividend received.

Although the application of Section 101(18) was raised in the case of *Johnson* v. *Commissioner,* decided January 17, 1952 (1952 P-H T.C. Memorandum Decisions, par. 52,007), appeal dismissed April 7, 1952 (C.A. 9th), it was not passed upon by the Tax Court. There appear to be no other reported decisions dealing with the section. However, the hearings before the Senate Finance Committee pertaining to the Revenue Act of 1936, c. 690, 49 Stat. 1648 (Hearings before the Committee on Finance on H. R. 12395, Part 11, May 28 and 29, 1936, 74th Cong., 2d Sess.), shed some light upon its purpose and intended application. During those hearings (which appear to constitute the only legislative history pertaining to Section 101(18)), reference was made to (p. 46) ''apostolic organizations who have a community interest,'' such as the House of David, the Shakers, and the Holy Rollers, whose members upon entering such organizations ''put in all of their property * * * and do a community business, run community farms, and all of the revenue is put in one pot and they are taxed

as a corporation.'"[9] We submit that it is clear from the Tax Court's findings and our discussion under Point II, *infra,* that the sole purpose of the Committee was to conduct the temporal affairs of the Church and that these affairs consisted principally of various commercial enterprises, and, therefore, that it was neither a religious or apostolic organization, nor did its members live the type of communal religious life contemplated by Section 101(18), so as to entitle them to the tax benefits accorded by that section.

II

THE CONTRIBUTIONS BY TAXPAYERS TO THE CHURCH, OR ITS PRINCIPAL TEMPORAL AGENCY, THE ELECTED DELEGATES COMMITTEE, ARE NOT DEDUCTIBLE UNDER SECTION 23(o)(2) OF THE INTERNAL REVENUE CODE OF 1939

Having determined that the income from the operation of the restaurant was taxable to Peggy Lou, there remains for consideration the question of whether she was entitled to deduct any part (15 per cent of her adjusted gross income) of the amount which she contributed to the Committee as a charitable contribution under Code Section 23(o)(2).[10] Although the Tax Court assumed a distinction between the Committee, the so-called "principal temporal agency" (R. 83) of the Church, and the "ecclesiastical society"

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[9] The purpose of the amendment appears to have been to afford some tax relief to persons, whether single or married, living a communal religious life, and who, because of the pooling of their earnings in an association taxed as a corporation, were unable to claim any personal or dependency exemptions.

[10] These same considerations also determine the deductibility of the contributions made by taxpayer Grassmee.

(R. 94) of the Church, we submit that no such distinction is warranted.

The Church itself was the organization which was incorporated as a religious body. (R. 81.) The fact that within itself it chose (according to its constitution and canon laws) to segregate its so-called "ecclesiastical" affairs from its temporal activities does not serve to create two separate and distinct entities insofar as its status as an exempt or non-exempt organization for tax purposes is concerned. As a matter of fact, even within the organization of the Church itself, any such distinction is without substance. The "ecclesiastical" functions of the Church were under the control of a "Senior Elder," and "Advisory Board of Elders," and a "College of Pastors." (R. 23-26.) No one could become a member of the Board unless confirmed by the Senior Elder (R. 24); the Board could only act subject to the written consent of the Senior Elder (R. 24-25); and the College of Pastors had only such powers as prescribed in writing by the Senior Elder (R. 26). The "temporal agencies" of the Church (of which the Committee was the principal one) were in turn "under and subject to the control of the ecclesiastical authorities" (R. 26), and were to operate only under charters granted by the Senior Elder with the advice of the Advisory Board (R. 25-26). At most, the constitution and canon laws of the Church specified only that "Insofar as practical" the ecclesiastical and temporal affairs of the Church should be kept separate. (R. 26, 33.) Obviously, then, the ecclesiastical and temporal agencies of the Church

were merely functional aspects thereof, and they in turn were under the complete dominion and control of the Senior Elder. To determine the question of deductibility, we address ourselves, therefore, to a consideration of whether the organization incorporated as "Christ's Church of The Golden Rule"[11] qualified as a religious organization so as to render contributions or gifts to it deductible under the provisions of Section 23(o)(2).

Insofar as pertinent here, Section 23(o)(2) provides three general conditions for deductibility. Two of the conditions are found in the requirement that the corporation be "organized and operated exclusively for religious * * * purposes"; the third is that "no part of * * * [its] net earnings * * * inures to the benefit of any private shareholder or individual." The Church does not fulfill any of these requirements or conditions.

As is apparent from its constitution, canon laws, and activities, the Church was not "organized and operated exclusively for religious" purposes. In fact, it appears therefrom that a substantial, if not the primary and fundamental, purpose of the Church was to operate commercial enterprises. To that end, the constitution and canon laws provided for the establishment and operation of so-called "temporal agencies"[12] of the Church. (R. 26-28, 33-40.) Such agencies were to hold their property in trust for the

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[11] The evidence does not support the Tax Court's finding (R. 81) that this Church "is" a religious nonprofit corporation. It was merely incorporated as such.

[12] See fn. 2, *supra*.

benefit of the "ecclesiastical organization" (R. 27-28, 33); they were to operate under charters granted by the Senior Elder with the advice of the Advisory Board (R. 26-27, 34); the income from the operations of any such agency or project was to belong to the "ecclesiastical" society of the Church and used for carrying on its "work" and "purposes" (R. 28, 37-40). The ostensible purpose of the Church appears to have been to promote a so-called "economic equality" (R. 22, 31-32) by having its members divest themselves of all private rights of ownership of property in favor of the Church, and thus "particularly to promulgate * * * the economic teachings of Christ Jesus" (R. 31). Exactly what "teachings" were referred to and how they were given "practical application" (R. 32) through the operation of the various projects is not explained.

In operation, as the Tax Court pointed out (R. 95), the record discloses "little evidence of activities of a purely spiritual nature, as commonly understood, being carried on by the Church." The Church had no church buildings, and apparently engaged in no formal religious exercises, but rather professed, *inter alia* (R. 32)—

> to teach and promote the spiritual, moral and financial welfare of all mankind by the practical application of Christianity; * * * to teach and exemplify the use of money or credit in any and all of its economic functions, and generally to teach and exemplify worthy and righteous business methods and scientific ways of procedure based upon Christ Jesus' "Golden Rule" of

absolute and impartial universal economic equality.

These announced purposes were allegedly carried on in part by "Student Minister Training Projects," most of which were engaged in commercial activities (R. 83, 95), such as the one operated by taxpayer Riker. As the Tax Court found (R. 83), the Committee, which operated these projects, carried on various commercial activities in competition with privately owned enterprises, including, among others, a restaurant, a laundry, a lumber yard, bulb gardens, farming, stock raising, and a warehouse. These enterprises were operated for profit, and the gross receipts were sent to the Committee covered by a form stating that the transfer was an outright gift from the project manager and was to be used only for Church purposes. (R. 83.) As the Tax Court said (R. 95), the very means chosen by the Church to attain its "spiritual purpose" involved engaging in commercial activities through its principal temporal agency, the Committee.

It is apparent, therefore, that the Church was neither organized nor operated exclusively for religious purposes, and that, as the Tax Court held (R. 93, 95), taxpayer Riker is not entitled to any deduction under Section 23(o) for the contributions turned over to the Church Committee.

Even if we assume, *arguendo,* as did the Tax Court (R. 92-93), that the ecclesiastical society of the Church, as distinguished from the Committee, qualified as a religious organization under Section 23(o), tax-

payers are still not entitled to any deduction. In so holding, the Tax Court referred to its decisions construing Section 101(6)[13] of the Code to the effect that, even though an organization is organized and operated to produce income for a tax exempt body, that fact does not render the producing entity (here, the Committee) exempt from taxation. At the same time, it recognized that some appellate courts had disagreed with its decisions in this respect. See, for example, *Roche's Beach, Inc.* v. *Commissioner,* 96 F. 2d 776 (C.A. 2d), reversing 35 B.T.A. 1087; and *C. F. Mueller Co.* v. *Commissioner,* 190 F. 2d 120 (C.A. 3d), reversing 14 T.C. 922. However, this Court has refused to apply this so-called "ultimate destination" test in several cases. See *John Danz Charitable Tr.* v. *Commissioner,* 231 F. 2d 673 (certiorari denied, October 8, 1956); *Ralph H. Eaton Foundation* v. *Commissioner,* 219 F. 2d 527; *Bear Gulch Water Co.* v. *Commissioner,* 116 F. 2d 975, certiorari denied, 314 U.S. 652; cf. *Squire* v. *Students Book Corp.,* 191 F. 2d 1018. And see *United States* v. *Community Services,* 189 F. 2d 421 (C.A. 4th), certiorari denied, 342 U.S. 932, where the ultimate destination test was rejected by the Fourth Circuit. As was the *Danz* case, so is this case, insofar as it relates to this point, controlled by this Court's decision in the *Ralph H. Eaton Foundation*

[13] Sections 101(6) and 23(o)(2) of the Internal Revenue Code of 1939 are similarly worded in their descriptions of organizations which are exempt and to which contributions may be deducted, so that it would appear that, if an organization is not entitled to tax exemption under Section 101(6), taxpayers making contributions to it would not be permitted to deduct those amounts under Section 23(o)(2).

case. As in the latter case, so here, as has been pointed out, the record and the findings of the Tax Court show that the Committee was actively and exclusively engaged in various commercial or business enterprises (R. 83, 95), and clearly was not intended to and did not operate as a religious organization. Furthermore, even if it be assumed, as was done in the *Eaton* case, that the function of the Committee in turning over the proceeds or contributions was an activity or operation, it certainly was not the exclusive one as required by the statute. Under the circumstances, then, no useful purpose would be served in any lengthy analysis of the decisions of other courts, cited by taxpayer (Br. 34-42), allegedly applying this test.

The Tax Court did not consider the third requirement of Section 23(o), namely, that no part of the net earnings of the Church inure to the benefit of any private individual, apparently on the theory that it was not necessary since the first two conditions had not been met. It is obvious, however, that taxpayer must also fail in her contention because of failure to prove this third condition. While, on the one hand, it is not possible to determine the "net earnings" of the Church and whether any part inured to the benefit of a private individual since its books and records were not produced in evidence; on the other hand, taxpayer stated in her 1948 return (R. 86-87) that in 1948 she and her daughter each received a 1/575 interest, or $377.39 each, in $217,001.54 "net income" of the Committee. Similarly, the Committee's returns as an "apostolic society" showed the undistributed

pro rata share of each member thereof to be $342.27 for 1948 and $316.17 for 1949. (R. 84.) In addition, the "Church Government" established a budget on which each local group or project levied which averaged between $17 and $20 per individual per month and "covered all living expenses."[14] These sums were made available through "revolving funds"—one to meet the operating expenses of each project, the other to meet the living expenses of the particular group. The funds for the "revolving funds" in turn appear to have come from the gross receipts from the operation of the various projects which were turned over to the Committee. (R. 117-119, 122-123, 125, 137, 147-148.) Insofar as appears from the record then, the members of the Church did share in the net earnings of the Church, and for this reason also it cannot be said to qualify as a religious organization, contributions to which are deductible under Section 23(o)(2).

It is no argument to say, as taxpayers do (Br. 23-29), that Section 101(6) must be given a liberal interpretation. It is a familiar rule of construction that deductions are a matter of legislative grace, not of right. *Deputy* v. *duPont,* 308 U.S. 488, 493; *New Colonial Co.* v. *Helvering,* 292 U.S. 435, 440. In any event, general rules of construction, while sometimes helpful in resolving ambiguities, cannot serve to defeat the plainly expressed legislative intent even where religious or charitable organizations are involved. *United States* v. *Community Services, supra;*

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[14] During the years 1948 and 1949, there was a cash fund for petty purchases in the amount of $5 per individual per month. (R. 135.)

Universal Oil Products Co. v. *Campbell,* 181 F. 2d 451 (C.A. 7th), certiorari denied, 340 U.S. 850; *Scholarship Endowment Foundation* v. *Nicholas,* 106 F. 2d 552 (C.A. 10th), certiorari denied, 308 U.S. 623. As the Supreme Court said in *Better Business Bureau* v. *United States,* 326 U.S. 279, 283:

> Even the most liberal of constructions does not mean that statutory words and phrases are to be given unusual or tortured meanings unjustified by legislative intent or that express limitations on such an exemption are to be ignored.

III

TAXPAYER GRASSMEE WAS NOT ENTITLED TO A DEPENDENCY CREDIT FOR HER MOTHER FOR THE YEARS 1948 AND 1949

As appears from the Tax Court's finding (R. 87), taxpayer Grassmee claimed a dependency credit for her mother on her 1948 and 1949 income tax returns. In an amended answer to her complaint, however, the Commissioner claimed increased deficiencies based on disallowance of the dependency credits claimed. (R. 80, 88.)

Although taxpayer has not briefed this point as a separate issue, it was raised as one of her points on appeal. (R. 161.) This dependency claim is mentioned by taxpayer, however, in connection with the contention that the Committee was an exempt organization under Section 101(18) (Br. 50, 53, 57), apparently on the theory, as the Tax Court thought (R. 87, 96), that part of the earnings taxpayer Grassmee turned over to the Committee was for the support of her mother

who lived with her in a Church residential project and participated in religious activities of the Church.

In sustaining the Commissioner's claims for increased deficiencies, the Tax Court pointed out that there was no evidence that the support received by the mother was conditioned on the making of a contribution or the payment of money by her daughter. It concluded, therefore, that taxpayer Grassmee did not furnish over half of the support for her mother during the years in question, and, hence, was not entitled to any dependency credit under Section 25(b)(1)(D) and (3) of the Internal Revenue Code of 1939, Appendix, *infra*. See *Tressler* v. *Commissioner*, 206 F. 2d 538 (C.A. 4th).

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(o) *Charitable and Other Contributions.* — In the case of an individual, contributions or gifts payment of which is made within the taxable year to or for the use of:

* * * * *

(2) [as amended by Section 224(a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] A corporation, trust, or community chest, fund, or foundation, created or organized in the United States or in any possession thereof or under the law of the United States or of any State or Territory or of any possession of the United States, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

* * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 25. CREDITS OF INDIVIDUAL AGAINST NET INCOME.

* * * * *

(b) [as amended by Section 10(b) of the Individual Income Tax Act of 1944, c. 210, 58 Stat. 231; Section 102(a) of the Revenue Act of 1945, c. 453, 59 Stat. 556; and Section 201 of the Revenue Act of 1948, c. 168, 62 Stat. 110] *Credits for Both Normal Tax and Surtax.*—

(1) *Credits.*—There shall be allowed for the purposes of both the normal tax and surtax, the following credits against net income:

* * * * *

(D) An exemption of $600 for each dependent whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than $500, * * *

* * * * *

(3) *Definition of Dependent.*—As used in this chapter the term "dependent" means any of the following persons over half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer:

* * * * *

(26 U.S.C. 1952 ed., Sec. 25.)

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

The following organizations shall be exempt from taxation under this chapter:

* * * * *

(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

* * * * *

(18) Religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even if such associations or corporations engage in business for the common benefit of the members, but only if the members thereof include (at the time of filing their returns) in their gross income their entire pro-rata shares, whether distributed or not, of the net income of the association or corporation for such year. Any amount so included in the gross income of a member shall be treated as a dividend received.

(26 U.S.C. 1952 ed., Sec. 101.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.25-3 [as amended by T.D. 5517, 1946-2 Cum. Bull. 8, and T.D. 5687, 1949-1 Cum. Bull. 9]. *Personal exemption, surtax exemptions, and exemptions for both normal tax and surtax.*—

* * * * *

(d) *Taxable years beginning after December 31, 1947.*— * * *

* * * * *

(5) *Exemptions for dependents.*—Section 25(b)(1)(D) allows to a taxpayer an exemption of $600 for each dependent whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than $500, who receives more than one-half of his support from the taxpayer for such calendar year and who does not file a joint return with his spouse. * * *

* * * * *

Sec. 29.101(6)-1. *Religious, Charitable, Scientific, Literary, and Educational Organizations and Community Chests.*—In order to be exempt under section 101(6), the organization must meet three tests:

(1) It must be organized and operated exclusively for one or more of the specified purposes;

(2) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals; and

(3) It must not by any substantial part of its activities attempt to influence legislation by propaganda or otherwise.

* * * * *

Since a corporation to be exempt under section 101(6) must be organized and operated exclusively for one or more of the specified purposes, an organization which has certain religious purposes and which also manufactures and sells articles to

the public for profit, is not exempt under section 101(6) even though its property is held in common and its profits do not inure to the benefit of individual members of the organization. * * *

* * * * *

Sec. 29.101(18)-1 [as amended by T.D. 5458, 1945 Cum. Bull. 45, and T.D. 5600, 1948-1 Cum. Bull. 5]. *Religious or Apostolic Associations or Corporations.*—Religious or apostolic associations or corporations are exempt from taxation under chapter 1 if they have a common treasury or community treasury, even though they engage in business for the common benefit of the members, provided each of the members includes (at the time of filing his return) in his gross income his entire pro rata share, whether distributed or not, of the net income of the association or corporation for the taxable year of the association or corporation ending with or during his taxable year. Any amount so included in the gross income of a member shall be treated as a dividend received.

Every association or corporation claiming exemption as a religious or apostolic association or corporation under the provisions of section 101(18) and this section shall make for each taxable year a return on Form 1065 * * * stating specifically the items of its gross income and deductions, and its net income, and there shall be attached to the return as a part thereof a statement showing the name and address of each member of the association or corporation and the amount of his distributive share of the net income of the association or corporation for such year. If the taxable year of any member is different from the taxable year of the association or cor-

poration, the distributive share of the net income of the association or corporation to be included in the gross income of the member for his taxable year shall be based upon the net income of the association or corporation for the taxable year of the association or corporation ending within the taxable year of the member.

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No. 15,072

United States Court of Appeals
For the Ninth Circuit

PEGGY LOU RIKER and FREDA H. GRASSMEE,

Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

APPELLANTS' PETITION FOR A REHEARING.

HOWARD B. CRITTENDEN, JR.,
One Eleven Sutter Street,
San Francisco 4, California,
Attorney for Appellants and Petitioners.

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No. 15,072

United States Court of Appeals

For the Ninth Circuit

PEGGY LOU RIKER and FREDA H. GRASSMEE,
Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

APPELLANTS' PETITION FOR A REHEARING.

To the Honorable Chief Judge Denman, Circuit Judge Fee, and District Judge Ross:

The above named appellants, Peggy Lou Riker and Freda H. Grassmee, request and petition for a rehearing in the above entitled matter from the decision made and filed April 12, 1957.

Pursuant to Rule 23 of this Court, the appellants suggest that because of the far-reaching effect, and the importance of the matters decided in the majority decision, the case should be heard en banc.

For grounds of this petition, your appellants respectfully show the following grounds:

FREEDOM OF RELIGION.

Both the appellants' cases involve gifts of money to a third party for religious purposes of a particular

church. Both involve gifts made with specific written directions that the money was given for the religious purposes (Ex. 8, Church form 399).

A donor under Sec. 23 (o) is permitted a 15% deduction from gross income, for charitable, religious and other contributions.

A gift is deductible under Sec. 23 (o) when made to a fund organized and controlled by a non-exempt organization, where the purpose of the fund is within this section.

Faulkner v. Comm. (CCA-1) 112 Fed. 2d 987.

Indeed, most gifts in trust for religious, charitable or other purpose are made to a bank or trust company, or other trustee who is not in any sense of the term an exempt organization under any tax laws. The terms of the trust determine whether the trust is or is not within Sec. 23 (o).

Notwithstanding this basic principle of law, this decision in the case at bar turns the question of deduction under 23 (o) as to whether the trustee under the express trust is an exempt organization and that the ecclesiastical organization of the spiritual body is also not tax exempt because part of its activities involve application and the spreading of Christianity by unconventional means of applying its teachings to everyday life rather than to talk or sing about them.

Not only were the gifts involved made under direct written statements transmitting the funds to the recipient in trust for religious purposes (Ex. 8) but also the church laws under which the donee-trustee

received the gift provides that all money and property must be held under a trust for religious purposes (Finding Rp. 82; Canon Law 20, Rp. 52) and the church organic laws contain numerous safeguards and remedies to guarantee the use of the money under this trust solely for the religious purposes.

It is a basic concept of our law, and United States Constitution, Amendment 1, that the government does not prefer one religion over another. The deduction of Sec. 23 (o) is applicable regardless of the spiritual body or identity of the religion to whom this money is given in trust for religious purposes.

A.

Should it be the law that a donor will or will not be granted the deduction of Sec. 23 (o) for gifts for religious purposes, and therefore taxed a greater sum depending upon the particular religious or spiritual body or ecclesiastical organization exercising discipline over the particular religion, then the very basic and important concept of freedom of religion is subject to a material limitation. Insofar as the decision involved in this case turns taxability of a gift in trust for religious purposes upon either the exempt status of the donee-trustee or the organization exercising discipline over the spiritual body of the church or the particular religious beliefs, this decision has a very far-reaching effect.

B.

A major part of the decision turns upon a denial of the Section 23 exemption because the spiritual body's

organization and the committee as its agent as a means to attain the spiritual purposes of the church, engage in activities in which portions of the costs are deferred by the related income of the activity through charges to the public. On page 14 of the decision, it is stated "Even though the church and its members may have lauded the spiritual end of these enterprises and turned a blind eye to the profits and it remains the fact that much of the life blood" came from these activities.

It would therefore appear that if the spiritual organization and its committee had confined its activity to study of religion and spread of religion by verbal means, and not have extended its spiritual activities to showing and proving by precept and example for others to view, that Christianity is applicable to everyday life, that the gift would be deductible under Sec. 23 (o), and by dictum the church committee would be tax exempt.

It therefore appears that so long as one holds religious views which are practiced only by words, written, spoken and sung, that the party is entitled to a Sec. 23 (o) deduction from his gross income, and the church and its organization entitled to the subdivision 6 tax exemption. However, if the particular religious organization believes that its religion can be and should be applied to everyday life, and attempts to prove it and to spread its religion through this means, then those belonging to the particular church or holding its belief are denied the 23 (o) deduction, and the religious organization is therefore penalized. Stated

simply, so long as religion is confined to verbalizing, it is tax exempt. Whenever a religion teaches that religion is something that can be used and applied to everyday life, and undertakes to demonstrate it, then this religion is to be penalized; the life blood of the church organization is to be struck and cut off by taxation not otherwise extended to churches and other religious organizations, and those who make gifts not for this particular activity, but only in trust for the religious purpose of this particular belief, are to be taxed at a greater rate by denial of the 23 (o) deduction.

C.

The decision on page 14 after commenting that the church and its members have lauded the spiritual end of the activities, and turned a blind eye to the profit end, observes that a church activity conducted by Riker, would in the Court's opinion not permit those coming in contact with the public to effectively demonstrate or show this particular religious application. The decision then follows with the comments that the garb of a cook or a waiter, and the casual relationship between the student ministers and the patrons, seem poorly designed to spread the fame of their order.

We might also observe that the difference between profanity and prayer differs little in the vocabulary, but principally in the manner and attitude in which the words are spoken or used. We should also observe that the garb of a clergyman can also cloak a saint or

a sinner, and that clothes do not necessarily make the man. Undoubtedly a uniform will make a soldier on the parade grounds, and undoubtedly assists in battle; but when battle is the payoff, it is not the garb of the soldier that keeps the man in the face of death or imminent danger from running. The thing that distinguishes between a coward and a soldier is not the garb, but the man; it is the character and training not the dress; it is the substance not the form that determines these things. So in this particular religion, it is the manner and attitude in which a person does everyday life activities that determine whether he is a saint or a sinner. It was never in prior decisions or the intention of Congress enacted in statute that the 23 (o) deduction to a donor would or would not depend upon whether the particular religion did or did not use an effective means to spread the particular religious beliefs.

This decision has a far-reaching effect when it holds that the person making a gift for religious purposes will or will not be entitled to a 23 (o) deduction, and therefore be taxed greater or less depending upon his or her religious beliefs, and whether these religious beliefs are disseminated by means which the particular judge or administrative official applying the law considers to be effective means.

D.

A basic premise in the laws and political institutions in this country, is that a person may believe that which he wishes in matters of religion without govern-

mental interference because of that religious belief. In the case at bar, both Riker and Grassmee are denied the Sec. 23 (o) deduction, and therefore taxed more than others who make comparable gifts to other trusts for religious purposes, simply because the religious beliefs are those held by persons who comprise a group under the common discipline of an ecclesiastical organization using a particular form of church government. The test turns, therefore, upon the particular spiritual organization of the particular groups holding a religious belief.

In the case at bar, it appears that if the spiritual head of the organization has more powers or authority than another church organization, the particular differential in taxation applies. So if Miss Nordskott, the Senior Elder of this particular church for the past number of years, as ecclesiastical head of the church has power to supervise and veto the acts of other ecclesiastical officers, etc., and the advisory board is elected by the convention but may serve only if confirmed by the Senior Elder, and this board can only exercise authority granted them by Miss Nordskott as Senior Elder, and the College of Pastors have only such powers and duties as may be prescribed in writing by Miss Nordskott as Senior Elder, and this Senior Elder has control in ecclesiastical matters over the temporal agencies, it appears that the actual vesting of this power in Miss Nordskott as Senior Elder therefore has the effect of making gifts in trust for religious purposes of that church not deductible, and would and does make the Committee sub-

ject to this ecclesiastical control, taxable. The Reply Brief page 7, et seq., points out that the form of church government does not determine whether donations for the church's religious use are or are not deductible under Sec. 23 (o) and that there are in general three forms of church government, of which the classification of episcopacy or prelacy is but one.

57 C.J. 7, Religious Societies 4;

Watson v. Jones, 80 U.S. 679, 20 Law. Ed. 666.

The form of ecclesiastical organization has not heretofore been any test for determination of a Sec. 23 (o) deduction. A gift need be only for religious use, and Congress did not intend to restrict this deduction for religious use to those of churches having any particular form of ecclesiastical church government.

A far-reaching effect of this decision is that gifts in trust to a religious use will be allowed as a deduction under Sec. 23 (o) depending not only upon the practices of a particular religion, and its effectiveness in spreading religion, but also upon the particular form of church government used by the particular church.

We urge that the Court consider the basic assumptions heretofore applicable to religious freedom, that a person may hold any particular religious belief without suffering additional taxation therefor. A person may belong to a religious society, and should not be penalized by paying additional taxes because the particular church uses a certain means or form of spreading religion by applying it to everyday life. A person may hold any religious belief, and should not

be taxed at a greater sum than another, simply because this person makes donations for religious use, in trust, to a church that uses a particular form of church government or organization. No test of taxation, and no computation of taxable income should depend upon any person's particular church's belief, church organization or religious practices. So long as a church organization does not damage, injure or hurt another, it should without restriction be permitted to use whatever lawful means are at hand or that the church wishes to apply to spreading of its religion, whether entirely confining its activities to verbal acts, or to actually applying the religious belief to everyday life.

EXEMPT ORGANIZATIONS.

Although we pointed out in the appellants' briefs that the wording of Sec. 23 (o) and Sec. 101 sub. 6 are identical, in actual judicial construction there were different rules applicable. We point to our briefs for the collection of authorities.

The particular decision in this case has very far-reaching and important implications, in that it holds any activity in which there is sought money or profit, even though this be connected with and a part of the spiritual purposes, is in fact sufficient to deny the particular church its exemption.

The factual statements show that the church and its members laud and consider the spiritual ends of the activities applying Christianity to everyday life,

and turn a blind eye to the profit end. The record shows that in fact there was no profit financially in any of the periods involved, from any of these operations, and in fact the costs of conducting them were more than the related income that was a by-product of these spiritual activities using this particular means to apply and spread Christianity.

This particular decision holds, and it is precedent for, the denying of a Sec. 23 (o) exemption to any person making a gift in trust for religious purposes of any church in which any organizations under the ecclestiastical control of that church does any activity for which charges are made. The spiritual organization is also taxable.

This means that the Church of Latter Day Saints, the Mormon Church, with its far-flung interests, some of which are engaged in clearly commercial enterprises, will be and must be taxed, and all gifts and tithes to the church for religious purposes are taxable and not deductible as a charitable or religious donation.

This means that the Christian Science Church, because it maintains large newspapers and a publication society, and sells newspaper and advertising space to the public, will be within this category and the donors denied the religious deduction.

This means that the Catholic Church, the established church of Rome, because it has within it organizations under its ecclestiastical control, organizations engaged in activities that make charge to the

public, as for an example the Christian Brothers Winery, will also fall within this category.

It means that any church that has a publication society that sells publications, would and must fall within this classification, even though the spiritual end is the main consideration, and a blind eye is turned toward the profit end.

It means that every church which, as part of its activities, has any organization or agency subject to its ecclesiastical control that runs a hospital making charges for its services, must be and is also within this classification.

Page 8 of the decision points out that Canon Law 3 grants control to the spiritual body over the organizations acting in temporal matters for the church, even if these ecclesiastical determinations directly or indirectly affect the temporal matters.

This is a statement of the general principles of law applicable to all churches, and the spiritual body does and must control those under it who hold or act in property matters within the sphere or under the discipline of the particular spiritual body.

Ecclesiastical control by the spiritual body's organization often does affect the property matters of the various agencies or entities acting within the organization. For example, a parish or congregation may be divided which in effect terminates the organization acting for and holding property within that jurisdiction of the spiritual body, and two or more entities are in fact created as illustrated in the case of

Wheelock v. First Presbyterian Church, 119 C 477. There may be a schism or division in religious beliefs or organization, in which the spiritual body then recognizes and supports one of the factions. The effect of this is that the property follows the particular group or organization recognized by the spiritual body. For an example of this, see *Watson v. Jones,* 80 U.S. 679. All ecclesiastical organizations controlling the spiritual body of a particular religious organization, actually exercise ecclesiastical control over the various entities under its discipline. In the case at bar, the ecclesiastical organization headed by Miss Nordskott, as Senior Elder, is authorized to and does exercise this ecclesiastical control over the various parts of the organization. One part of the church organization, and the one involved in this litigation, is the activity where those engaged full time in the Church's work live in an apostolic society to enable them to give their time. This is but a part of the total membership and but one of the various activities of this Church.

The decision in the case at bar has far-reaching effects and implications in that it holds mere ecclesiastical control of but one activity within the entire spiritual body, which is held not to be an exempt organization, bars the Sec. 23 (o) deduction to any donor in trust for religious purposes of the religious movement.

APOSTOLIC SOCIETIES.

The opinion of the Court in the case at bar shows and states on page 18 of the decision that the portion of the church membership living in the apostolic society, has no tangible or property interest in the activities of the church. Yet the opinion of the Court and the concurring opinion of Chief Judge Denman denies the 23 (o) exemption because the apostolic society actually supports its members engaged in the church work.

When we consider that this is but a portion of the total membership of the religious society, and constitutes only those who are working full time in the church's work, we have a situation where the receipt of the barest necessities to enable a person to work full time in the church's work disqualifies any gift under Sec. 23 (o).

The holding of this decision has, therefore, far-reaching effects.

In our society, a church can only operate when it has money. This is the life-blood of its activity. It follows that in any religious organization, if any of those giving their services receive so much as their meals or any benefit to permit them to carry on the work, therefore the organization is no longer exempt, and all donations are no longer subject to the deduction of Sec. 23 (o). A stronger situation is where any person receives compensation or pay for these services.

The various cases cited in appellants' brief involving apostolic societies, sometimes arise when a person

who has been or is a member seeks to obtain a portion of the money or property in the common community treasury. These cases uniformly hold that there is no right of recovery. The case at bar in effect holds that in an apostolic religious organization where the members do not have a tangible and actual interest and contract right in the common community treasury and its income, then the Subdivision 18 provisions do not apply.

We should point out the inconsistency appearing in this decision, first that Grassmee and Riker are taxable because they have benefits accruing to them because they are provided the necessities of life to permit them to carry on their church work. Yet, under the provision of Sub. 18, this interest that they have which disqualifies them and the organizations for the ordinary tax classification of a church, is shown and held to be no more than spiritual comfort and the association in the religious group and its doctrines.

DEPENDENCY DEDUCTION.

The case at bar held that Mrs. Grassmee, who gave all, or substantially all of her personal earnings at private employment to the church Committee in trust for religious purposes, was not entitled to the Sub. 23 (o) deduction because part of this money she gave enured to her benefit. Yet because her mother lived in this group, and received her support from the church Committee, because of

her dependency upon Mrs. Grassmee, she can claim no credit for support of her mother. We need then ask who supported the mother? If Mrs. Grassmee had given this money to a commercial institution in return for the support of herself and her mother, she would certainly be entitled to credit for the dependency support. If the donation enured to the benefit of Mrs. Grassmee and her mother and others in the group, which is the holding of the majority decision, it would therefore follow the mother received some benefits which were support of her by Mrs. Grassmee. If the money was given, we then ask does the mother's care fall within a charitable institution's support, or is it part of this benefit that enured to the donor, the daughter of this woman supported?

RIKER.

Mrs. Riker conducted the activity at San Bernardino, as the spiritual head and leader of a group of 12 to 17 persons. It was the services of this group that created this activity, and the $8,900 held taxable to her was the product of these 12 to 17 persons' services. No deduction was made from this $8,900 shown in her tax return for any of the services or the cost of support or maintenance of these 12 to 17 persons while they were performing these services and engaged in this religious activity. All gross receipts of the activity were immediately deposited in the name of the Committee. All money for expenses were supplied by the religious Committee through the local

project fund. Riker, if she is charged with this $8,900 as personal income, which was not the total sums paid to the church, but only a fraction of it, should have deducted all actual expenses of the Committee spent for the food, clothing, housing, etc. of the 12 to 17 persons whose services were engaged in this activity as well as other deducted costs paid by the Committee. In any commercial enterprise, the cost of services must, of necessity, be deducted as a cost of doing business. This is not the case in the Riker decision, and she is, as head of the local group, charged not with personal income taxes upon the gross gifts, nor upon the net gifts, but only upon the portion without deduction for any cost of labor ordinarily computed in determining actual net operating profits.

The record shows that during 1948, one of the years involved, actual title to this restaurant property vested in the church Committee, and the church Committee paid to the trustees in bankruptcy the consideration therefor. The Committee, not Riker, sold and received the proceeds from this property. The services of the 12 to 17 persons working and engaged in the church work in the San Bernardino group was not given to Mrs. Riker, and not intended for her in any way. Yet neither the cost of those services to the Committee, nor their value, is deducted in arriving at taxable income to Mrs. Riker, the related income of this group of 12 to 17 persons.

The decision on page 19 states that the taxpayers Grassmee and Riker are not entitled to the deduction under Sec. 23 (o), nor to the deduction under Sec. 101

Sub. 18. We read this to mean from the prior paragraph on page 18 of the decision, that those in the apostolic society do not have a tangible and definite interest in the religious apostolic society's common community treasury or its income, yet Sub. 18 is not a deduction of those in the society. Those in the apostolic society are taxed for a proportional share of its income. We pointed out that if the money was donated, it should not be taxed to the donor, and also the proportional share under the apostolic society also taxed to the same donor (double taxation). We think this portion of the decision bears careful analysis, as it creates unnecessary confusion as it now stands. Sec. 101, Sub. 18 does not deal with any deduction to any member of an apostolic society.

CONCLUSIONS.

The decision as it now stands has tremendous far-reaching implications and impact upon all religious organizations and the taxability of these organizations and the taxability of donations under Sec. 23 (o).

The effect of this decision and its far-reaching implications, and its impact upon the present concepts of law applicable to taxation of donations to churches, and exemption of religious organizations, is such that this decision merits the closest scrutiny by the three members of the court sitting in this decision, and we believe by the entire Court en banc.

The fact of ecclesiastical control of but one portion of a religious organization, has by the rule of this

case, tremendous implications. Not this one organization alone, and not these two taxpayers alone, will be affected by this decision. Almost all of the various churches that are now in existence in this country will be directly affected by this decision. The many donors to any of these various churches affected, will also be affected. The law in effect since 1950, 26 U.S.C.A. 511, where unrelated business income is taxed, and related business income is not taxed, recognizes that there is income from related business income. Congress in Sec. 26 U.S.C.A. 511 by excluding churches from the unrelated business income tax, shows Congressional intention in taxing charitable organizations, and excluding churches who do have unrelated business income. This decision has the effect of nullifying the acts of Congress, enacted subsequent to the years herein involved, and also of changing the law as to donations, under Sec. 23 (o), now renumbered but unchanged in substance, because a church may have either related or unrelated business income and not be taxable as an exempt organization. By this decision any church having any entity or subdivision subject to its ecclesiastical control or discipline that makes any charges or sales may not obtain donations subject to the ordinary charitable and religious deductions. This, in effect, strikes at the very life-blood of all religious activities.

By this decision, if any person attempts to assist in any religious work, and receives so much as room or board or other benefit to permit the party to undertake this work, it is in effect enuring to the benefit of

that individual under both the charitable and religious deduction section and the organizations tax exemption law. This, therefore, strikes at the very life-blood of any worthy cause, including all religious societies who must hire persons or pay their expenses to permit them to engage in the church work.

We respectfully submit that a rehearing should be granted in this case. We request a consideration en banc.

Dated, San Francisco, California,
May 13, 1957.

HOWARD B. CRITTENDEN, JR.,
Attorney for Appellants and Petitioners.

Certificate of Counsel

I certify this petition is in my opinion and judgment well founded and meritorious and that it is not made for the purpose of any delay.

Dated, San Francisco, California,
May 13, 1957.

Howard B. Crittenden, Jr.,
Attorney for Appellants and Petitioners.

No. 15073

United States

Court of Appeals

for the Ninth Circuit

DESSER, RAU & HOFFMAN, and JACK L. RAU, individually, Appellants,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of Stockholders Publishing Company, Inc., a bankrupt, Appellee.

Transcript of Record

Appeal from the United States District Court
for the Southern District of California
Central Division

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif. —5-24-56

No. 15073

United States

Court of Appeals

for the Ninth Circuit

DESSER, RAU & HOFFMAN, and JACK L. RAU, individually, Appellants,

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Appeal from the United States District Court
for the Southern District of California
Central Division

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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* Page numbers appearing at foot of page of original Transcript of Record.

In the District Court of the United States, Southern District of California, Central Division

No. 64381—WB

In the Matter of STOCKHOLDERS PUBLISHING COMPANY, INC, a corporation, alleged bankrupt.

PETITION TO ALLOW PAYMENT OF EXPENSES

To the Honorable David B. Head, Referee in Bankruptcy:

The petition of Desser, Rau & Hoffman respectfully represents:

I.

That prior to the filing of the involuntary petition in bankruptcy herein, your petitioners acted as attorneys for Stockholders Publishing Company, Inc., a corporation, the above named alleged bankrupt. That during the period of December 20, 1954 to December 31, 1954, your petitioners acting as attorneys for said alleged bankrupt opened a bank account, designated as "Jack L. Rau, Special Account" at Union Bank & Trust Co., in which was deposited certain funds belonging to said corporation, and out of which certain disbursements were made. That an accounting of said receipts and disbursements was forwarded to George T. Goggin, Esq., Receiver herein, on January 5, 1955, at which time the said account contained the sum of $16,163.15. [2]

II.

In connection with your petitioners' representation of said alleged bankrupt since December 26, 1953, your petitioners have expended substantial sums of money for transportation to the East coast in connection with the affairs of the corporation, long distance telephone charges, traveling and hotel expenses. That said expenses amounted to $3217.68 as per Exhibit "A" attached hereto and made a part hereof.

III.

That your petitioners have remitted to the said Receiver the sum of $12,945.47 and have retained the sum of $3217.68 pending a determination by this Court as to whether or not your petitioners may offset said sums deposited with them by the alleged bankrupt with their out of pocket expenses.

IV.

That during the time your petitioners represented the alleged bankrupt, your petitioners never billed the corporation for fees, nor received any monies on account of fees from the corporation. That the said sum of $3217.68 retained by your petitioners represents no charge for fees.

Wherefore, your petitioners pray that an order be made and entered herein authorizing your petitioners to reimburse themselves from the "Jack L. Rau, Special Account" in the sum of $3217.68 for transportation, long distance telephone charges,

hotels, travel, etc. as hereinabove set forth. [3]

DESSER, RAU & HOFFMAN
/s/ By JACK L. RAU

EXHIBIT "A"

Long Distance Telephone Calls made from December 1953 to December 1954 on Crestview 5-4548 and Bradshaw 2-6531..... $ 326.33
Transportation (2 trips to New York, 1 trip to San Francisco and 2 trips to San Diego, and 1 trip to Chicago)..... 913.25
Traveling Expenses: Hotel, Meals, Long Distance Phone Calls, etc.
In New York—3/31/54-4/18/54
In Chicago—4/19/54-4/22/54
In New York—4/26/54-4/30/54
In San Diego—5/17/54
In San Diego—5/27/54 and 5/28/54
In San Francisco—6/8/54..... 1,978.10
Total .....$ 3,217.68

Duly Verified. [5]

[Endorsed]: Filed January 21, 1955.

[Title of District Court and Cause.]

ORDER TO SHOW CAUSE

Upon the petition of Desser, Rau & Hoffman for an Order to Show Cause, it is

Ordered, that George T. Goggin, Esq., Receiver

herein, show cause before the undersigned Referee in Bankruptcy, on the 24th day of February, 1955, at 10 o'clock A.M. in his courtroom, Third Floor Federal Building, Los Angeles, California, if any he has, why an order should not be made and entered herein granting the petition of Desser, Rau & Hoffman for authority to reimburse themselves in the sum of $3217.68 from the "Jack L. Rau Special Account" for transportation, long distance traveling charges, hotels, travel, etc. as per Exhibit "A" Attached to said Petition and made a part hereof by reference; and it is further

Ordered, that service of a copy of this Order to Show Cause and a copy of the Petition upon which it is based may be made by United States mail, postage prepaid, upon said respondent, if said service is made at least five days before the hearing thereon.

Dated: January 21, 1955.

/s/ DAVID B. HEAD
Referee in Bankruptcy. [6]

[Endorsed]: Filed January 21, 1955.

[Title of District Court and Cause.]

MEMORANDUM BY REFEREE, DESSER, RAU & HOFFMAN V. TRUSTEE

The law firm of Desser, Rau and Hoffman have petitioned for leave to reimburse themselves in the amount of $3217.68 from a fund under their con-

trol, held in a bank account known as the "Jack L. Rau, Special Account."

The facts set out in the petition are admitted to be true. I quote from Paragraphs I and III.

"That prior to the filing of the involuntary petition in bankruptcy herein, your petitioners acted as attorneys for Stockholders Publishing Company, Inc., a corporation, the above named alleged bankrupt. That during the period of December 20, 1954 to December 31, 1954, your petitioners acting as attorneys for said alleged bankrupt opened a bank account, designated as 'Jack L. Rau, Special Account' at Union Bank & Trust Co., in which was deposited certain funds [52] belonging to said corporation, and out of which certain disbursements were made. That an accounting of said receipts and disbursements was forwarded to George T. Goggin, Esq., Receiver herein, on January 5, 1955, at which time the said account contained the sum of $16,163.15.

"That your petitioners have remitted to the said Receiver the sum of $12,945.47 and have retained the sum of $3217.68 pending a determination by this Court as to whether or not your petitioners may offset said sums deposited with them by the alleged bankrupt with their out of pocket expenses."

Exhibit "A" shows that these expenditures were for phone calls and travel expense incurred from December 1953 to December 1954.

It is clear that Rau held the moneys in the special account as trustee or agent of the bankrupt

corporation and did not acquire any other interest in the fund. Petitioners have argued that they are entitled to set off their account against the funds in Rau's special account under the provisions of section 68a, Bankruptcy Act, which reads as follows:

"In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

It is clear to me that no mutuality of debts or credits are involved in this matter. Mr. Rau does not hold this fund as his own, but as trustee or agent of the bankrupt. He cannot and does not assert that this fund represents a [53] debt of his to the bankrupt. In fact the fund held by Mr. Rau is the property of the bankrupt.

Before the moneys were turned over to Mr. Rau, his law partner, Mr. Desser, who was a director as well as counsel for the bankrupt corporation, had full knowledge of the insolvency of the bankrupt corporation. At a directors' meeting on December 18, 1954 in which Mr. Desser participated, the directors authorized the president of the bankrupt corporation to institute bankruptcy proceedings. If a transfer of this fund were permitted it would date from December 20, 1954 or later. This would create a voidable preference under the provisions of section 60a of the Bankruptcy Act.

Petition is denied and the petitioners and Jack L. Rau, as an individual, are directed to pay over

to the trustee the amount held in the "Jack L. Rau, Special Account."

If findings and conclusions are not waived, counsel for trustee shall prepare, serve and present the same to the court together with an appropriate order.

Dated this 25th day of July, 1955.

/s/ DAVID B. HEAD
Referee in Bankruptcy. [54]

[Endorsed]: Filed July 25, 1955.

[Title of District Court and Cause.]

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

The verified petition of Desser, Rau & Hoffman seeking an order of this court allowing payment of expenses having come on for hearing before this court on the 10th day of March, 1955, petitioner being represented by Jack Rau, Esq., and the Trustee being represented by his counsel Robert H. Shutan and Craig, Weller & Laugharn by Robert H. Shutan, and the court having heard statements on behalf of the parties and arguments of counsel, and counsel for both sides having submitted memorandums in support of their respective positions, and the matter having been taken by this court under submission; now upon all of the proceedings had before it and upon all of the statements, plead-

ings and documents this court hereby makes the following Findings of Fact and Conclusions of Law and its Order thereupon:

Findings of Fact

I.

That prior to the filing of the involuntary petition in bankruptcy herein on December 31, 1954, petitioners Desser, [55] Rau & Hoffman, Attorneys at Law, acted as attorneys for Stockholders Publishing Company, Inc., the bankrupt corporation. That Arthur Desser, one of the partners in said law firm of Desser, Rau & Hoffman, was an officer and director of the bankrupt corporation, as well as counsel, during the entire month of December 1954, as well as for a number of months prior thereto.

II.

That at a meeting of the Board of Directors of the bankrupt corporation on December 18, 1954, at which meeting Arthur Desser was present and participated, the directors authorized the President of the bankrupt corporation to institute bankruptcy proceedings.

III.

That after ceasing its operation on December 18, 1954, the bankrupt corporation needed access to a new bank account for the protection of its incoming funds and for the making of certain essential disbursements from said funds. That for said purpose, on December 20, 1954, the petitioners Desser, Rau & Hoffman, acting as attorneys for the bank-

rupt corporation, opened at the Union Bank & Trust Company of Los Angeles, a bank account designated as "Jack L. Rau, Special Account". That in said account there was deposited certain funds belonging to the corporation, and out of said account certain disbursements were made.

IV.

That on January 5, 1955, petitioners herein rendered an accounting of said receipts and disbursements to George T. Goggin, the Receiver, at which time the said account contained the sum of $16,-163.15. That petitioners remitted to the Receiver the sum of $12,945.47 and have retained and still hold the sum of $3,217.68.

V.

That petitioners expended from their own [56] funds on behalf of the bankrupt corporation between December 1953 and December 1954, the sum of $3,217.68 for long distance phone calls and travel expense on behalf of the bankrupt corporation. That all of said expenditures and expenses were incurred prior to December 18, 1954.

VI.

That on December 31, 1954, the date of the commencement of these bankruptcy proceedings, on January 5, 1955, and at all times pertinent hereto, the subject sum of $3,217.68 has remained in said "Jack L. Rau, Special Account" at the Union Bank & Trust Company, Los Angeles.

VII.

That Jack L. Rau held the monies in said special account as Trustee or agent of the bankrupt corporation and said Jack L. Rau did not acquire any other interest in said fund.

VIII.

That the monies held by Jack L. Rau in the "Jack L. Rau, Special Account" at the Union Bank & Trust Company of Los Angeles constitutes property of the bankrupt corporation.

From the above Findings of Fact this court now makes the following:

Conclusions of Law

I.

Jack L. Rau held the subject monies in said special account as Trustee or agent of the bankrupt corporation and did not acquire any other interest in said fund.

II.

There is no mutuality of debts or credits between the funds held by petitioners and the obligation of the bankrupt corporation for the funds advanced by petitioners. The funds held [57] by Jack L. Rau on a special account constitute property of the bankrupt corporation.

Upon the foregoing Finding of Fact and Conclusions of Law this court now makes its Order.

Order

Upon all of the proceedings had before me in this matter and upon the foregoing Findings of Fact and Conclusions of Law, it is hereby

Ordered that Desser, Rau & Hoffman and Jack L. Rau individually pay over to George T. Goggin, Trustee herein, the sum of $3,217.68, being the amount held in the "Jack L. Rau, Special Account."

Dated: August 17, 1955.

/s/ DAVID B. HEAD
Referee in Bankruptcy. [58]

Affidavit of Service by Mail Attached. [59]

[Endorsed]: Filed August 17, 1955.

[Title of District Court and Cause.]

PETITION FOR REVIEW

To the Honorable David B. Head, Referee in Bankruptcy:

Come now your petitioners, Desser, Rau & Hoffman, and petition for a review of the order made and entered on August 17, 1955, and titled "Findings of Fact, Conclusions of Law and Order", and respectfully shows:

I.

Petitioners are, or were at the time of the events in controversy, partners in the law firm of Desser,

Rau & Hoffman with offices at 444 North Camden Drive, Beverly Hills, California.

II.

On January 21, 1955, petitioners filed herein their petition entitled "Petition to Allow Payment of Expenses", in which petitioners prayed that an order be entered authorizing them to reimburse themselves from an account known as the "Jack L. Rau Special Account" which had been created by petitioners in which certain funds of the corporation were deposited and out of which [60] certain disbursements were made. In said petition it was alleged that in connection with petitioners' representation of the bankrupt as its counsel prior to bankruptcy, and since December 26, 1953, petitioners expended the sum of $3,217.68 for which petitioners were not reimbursed, and which amount said corporation owed petitioners at the time of the filing of the petition in bankruptcy. It was further alleged in said petition that an accounting of deposits in and disbursements from said special account was made to the Receiver herein on January 5, 1955, at which time said account contained the sum of $16,163.15 and that petitioners remitted to said Receiver the sum of $12,945.47 and retained the sum of $3,217.68, the amount of their out of pocket expense, pending a determination as to whether or not they might offset said sum so retained against said out of pocket expense: all of which will more fully appear from the Petition to Allow the Payment of Expenses.

III.

Said petition came on for hearing before Referee David B. Head on the 10th day of March, 1955, at which time unsworn statements were made on behalf of the parties and said Referee heard the arguments of counsel for the respective parties. Counsel for petitioners and counsel for the Trustee in bankruptcy herein submitted memoranda in support of their respective positions and the matter was thus taken by the Court under such submission. No answer of the Receiver or Trustee in bankruptcy herein was filed and there was no sworn testimony or evidence on behalf of either side.

IV.

On July 25, 1955, said Referee filed his memorandum in which he concluded that petitioners' petition should be denied and directed that, if findings and conclusions were not waived, counsel for the Trustee should prepare, serve and present the same to the [61] Court together with an appropriate order. Thereafter on August 17, 1955, said Referee filed his findings of fact, conclusions of law and order denying the prayer of your petitioners' petition.

V.

Petitioners respectfully contend that the Referee erred in the following respects:

1. In denying the prayer of petitioners' petition.

2. In making findings of fact numbered VII and VIII on the basis of which the prayer of the petition was denied. Said findings VII and VIII do

not constitute ground or reason for the conclusion of law that petitioners possess no right of setoff or counterclaim as prayed in their petition.

3. In concluding as a matter of law that because said special account was created by petitioners and was held by Jack L. Rau as trustee or agent of the bankrupt, and did not acquire any other interest in said fund, petitioners counter-demand for an admitted indebtedness of the bankrupt to them is not allowable.

4. In concluding as a matter of law that there is no mutuality of debts or credits between the fund held by petitioners and the obligation of the bankrupt on its indebtedness to petitioners.

5. In holding that petitioners right of setoff or counter-claim is not allowable under Section 68 of the Bankruptcy Act.

6. In failing to hold that under Rule 13 (b) of the Federal Rules of Civil Procedure (which provides that "a pleading may state as a counter-claim any claim against an opposing party not arising out of the transaction or occurrence that is the subject matter of the opposing party's claim"), petitioners' counter demand is assertable in bankruptcy, (General Order No. 37, as amended, providing that in proceedings under the Bank- [62] ruptcy Act the Federal Rules of Civil Procedure shall be followed when not inconsistent with the Act or other general orders), and in failing to hold that the application of Rule 13 (b) is not inconsistent with any provisions of the Bankruptcy Act or with any other general order in bankruptcy.

7. In holding that there is no mutuality of debts or credits between the funds held by petitioners and the obligation of the bankrupt corporation for funds advanced by petitioners.

8. In holding that because the said special account constituted property of the bankrupt corporation, petitioners right of setoff or counterclaim cannot lawfully be maintained.

9. In failing to hold that "mutual credit" is not confined to ordinary pecuniary demands but extends to all cases where the creditor has in his hands, goods, money or choses in action belonging to the debtor which cannot be "got at" without suit at law or complaint in equity.

10. In failing to hold that the right of setoff or counterclaim in bankruptcy does not depend upon the variety or nature of the contract debt or the character of or position occupied by the parties.

11. In holding (in his memorandum dated July 25, 1955) that if a transfer to petitioners of the amount of their out of pocket expense, out of said fund were permitted, it would date from December 20, 1954 or later and would thus create a voidable preference.

12. In failing to hold that both before and after bankruptcy, the amount of the debt due petitioners could be setoff or counterclaimed against the amount due from petitioners to the bankrupt out of said special account, and that the taking or authorization to setoff or counterclaim as against said account of the amount so due to petitioners would not constitute an avoidable preference re-

gardless of when the setoff occurred or when [63] bankruptcy intervened.

13. In failing to hold that no question of avoidable preference is present in the instant proceedings.

Wherefore petitioners, feeling aggrieved because of the Order, Findings of Fact and Conclusions of Law of said Referee, pray that the same may be reviewed as provided by Section 39c of the Bankruptcy Act as amended; that said Order be reversed and remanded with directions to allow the prayer of petitioners' petition or reversed with an order by the Court, on review, allowing said prayer of said petition.

That the Honorable David B. Head, Referee in Bankruptcy, prepare his certificate of review and attach thereto the following:

1. The order of adjudication.
2. Petition of petitioners to allow payment of expenses.
3. Order to show cause of said Referee in said bankruptcy upon George T. Goggin, Esq., the Receiver herein, dated January 21, 1955.
4. The transcript, if any, of the reporter on the hearing on petitioners' petition on March 10, 1955.
5. Petitioners' brief in support of their petition.
6. Trustee's memorandum in opposition to petition to allow payment of expenses.
7. Reply of petitioners to Trustee's memorandum.
8. Memorandum by Referee dated July 25, 1955.

9. Findings of fact, conclusions of law and order of said Referee dated August 17, 1955.

10. Petition for review.

Respectfully submitted,

DESSER, RAU & HOFFMAN
/s/ By DAVID M. HOFFMAN
Petitioners. [64]

Duly Verified.

Affidavit of Service by Mail Attached. [65]

[Endorsed]: Filed August 26, 1955.

In the United States District Court, Southern District of California, Central Division

In Bankruptcy—No. 64381-WB

In the Matter of STOCKHOLDERS PUBLISHING COMPANY, INC., Bankrupt.

ORDER AFFIRMING ORDER OF REFEREE

The above entitled matter having come on regularly for hearing before the above entitled court on the 28th day of November, 1955, at 9:45 o'clock A.M., upon the Petition of Desser, Rau & Hoffman, for review of the Referee's Order of August 17, 1955, directing that Desser, Rau & Hoffman and Jack L. Rau pay over to George T. Goggin, Trustee, the sum of Three Thousand Two Hundred Seventeen and sixty-eight cents ($3217.68); and Desser and Hoffman by David Nisall appearing for

and on behalf of said Desser, Rau & Hoffman, Petitioners, and Robert H. Shutan and Craig, Weller & Laugharn by Robert H. Shutan appearing for and on behalf of said George T. Goggin, Trustee, and by agreement of all parties the matter having been submitted to the court upon the written briefs and points and authorities, and the court having duly considered the same, now it is hereby

Ordered that the Order of the Referee dated August 17, 1955, ordering that Desser, Rau & Hoffman and Jack L. Rau individually pay over to George T. Goggin, Trustee, the sum of $3217.68 be and [111] it hereby is approved and affirmed. It is further

Ordered that the Findings of Fact and Conclusions of Law of the Referee in said matter, also under date of August 17, 1955, are hereby approved and adopted as part of this Order.

Dated: January 11, 1956.

/s/ W. M. BYRNE
Judge of the U. S. District Court.

Approved as to form pursuant to Rule 7 (a), as amended.

DESSER & HOFFMAN and DAVID NISALL
/s/ By DAVID R. NISALL
Attorneys for Petitioners. [112]

[Endorsed]: Docketed, Entered and Filed January 11, 1956.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Desser, Rau & Hoffman, petitioners above named, and Jack L. Rau, individually, hereby appeal to the United States Court of Appeals for the Ninth Circuit from the order of the District Court of the United States, Southern District of California, Central Division, entered on January 11, 1956, affirming the order of Referee in Bankruptcy David B. Head, dated August 17, 1955, ordering that Desser, Rau & Hoffman and Jack L. Rau, individually, pay over to George T. Goggin, Trustee in bankruptcy of Stockholders Publishing Company, Inc., a corporation, in the sum of $3,217.68, and approving and adopting as part of said order on review the Findings of Fact and Conclusions of Law of said Referee in said matter, also dated August 17, 1955.

Dated January 31, 1956.

DESSER, RAU & HOFFMAN

/s/ By DAVID R. NISALL

Attorneys for Desser, Rau & Hoffman and Jack L. Rau individually. [113]

Receipt of Copy Attached.

[Endorsed]: Filed January 31, 1956.

[Title of District Court and Cause.]

UNDERTAKING FOR COSTS ON APPEAL

Know all men by these presents, that Fidelity and Deposit Company of Maryland, a corporation, organized and existing under the laws of the State of Maryland, and duly licensed to transact business in the State of California, is held and firmly bound unto George P. Goggin, Trustee, in the above case, in the penal sum of Two Hundred Fifty and no/100 ($250.00), to be paid to said George P. Goggin, Trustee, his successors, assigns or legal representatives, for which payment well and truly to be made, the Fidelity and Deposit Company of Maryland binds itself, its successors and assigns firmly by these presents.

The condition of the above obligation is such, That Whereas the firm of Desser, Rau, and Hoffman, and Jack L. Rau, individually, have appealed or are about to appeal to the United States Court of Appeals for the Ninth Court from an Order heretofore entered in this proceeding on January 11, 1956, which Order affirmed an Order by Referee Head, dated August 17, 1955, requiring Desser, Rau, and Hoffman, and Jack L. Rau, individually, to pay over to George P. Goggin, Trustee, the sum of Three Thousand Two Hundred and Seventeen and 68/100 ($3,217.68) and which approved and adopted the findings of fact and conclusions of law of said Referee Head.

Now, Therefore, if the above named appellant

shall prosecute said appeal to effect and answer all costs which may be adjudged against them if the appeal is dismissed, or the judgment affirmed, or such costs as the Appellate Court may award if the judgment is modified, then this obligation shall be void; otherwise to remain in full force and effect.

It is Hereby agreed by the Surety that in case of default or contumacy on the part of the Principal or Surety, the Court may, upon notice to them of not less than ten days, proceed summarily and render judgment against them [114] or either of them, in accordance with their obligation and award execution thereon.

Signed, Sealed and Dated this 30 day of January, 1956.

[Seal] FIDELITY AND DEPOSIT COMPANY OF MARYLAND

/s/ By ROBERT HECHT
Attorney-in-fact.

Approved this 31st day of January, 1956.

JOHN A. CHILDRESS
Clerk, U. S. District Court, Southern District of California.

/s/ By REX LAWSON

Notary Public's Certificate Attached. [115]

[Endorsed]: Filed January 31, 1956.

[Title of District Court and Cause.]

AFFIDAVIT

State of California,
County of Los Angeles—ss.

David R. Nisall, being first duly sworn, deposes and says:

That he has supervision of the appeal in the above entitled cause and together with another associate in his office had prepared a statement of the case, for purposes of the appeal, pursuant to Rule 76 of the Rules of Civil Procedure, but thereafter it was determined by counsel for petitioners-appellants and counsel for the Trustee in bankruptcy, respondent-appellee, that instead of presenting an agreed statement and instead of serving designations of the record, that the parties by written stipulation designate the parts of the record to be included in the record on appeal; that affiant has been practically constantly engaged in set matters and will be so engaged for some days to come; affiant further states that it is necessary [116] that an additional ten (10) days be granted within which to do such work as is necessary to docket the record on appeal. Affiant further respectfully requests the Court to grant an extension of ten (10) days to and including March 22, 1956.

/s/ DAVID R. NISALL
Affiant

Subscribed and sworn to before me this 8th day of March, 1956.

[Seal] /s/ PATRICIA BRADY
Notary Public in and for said County and State. [117]

[Endorsed]: Filed March 9, 1956.

[Title of District Court and Cause.]

ORDER

It is Hereby ordered that the time to docket the record in the above entitled case on appeal to the United States Court of Appeals for the Ninth Circuit be and the same is hereby extended ten (10) days, to and including March 22, 1956.

Dated: March 9, 1956.

/s/ W. M. BYRNE
Judge

There is no objection to the entry of the foregoing order. Robert H. Shutan and Craig, Weller & Laugharn. By Robert H. Shutan, Attorneys for respondent-appellee. [118]

[Endorsed]: Filed March 9, 1956.

[Title of District Court and Cause.]

STATEMENT OF POINTS TO BE RELIED ON BY APPELLANTS

1. The District Court erred in holding that appellants' claim for actual and admitted out-of-pocket expenses incurred on behalf of the bankrupt, prior to bankruptcy, is not the proper subject of a setoff or counterclaim against the claim of the bankrupt and its Trustee to the fund held by appellants in the "Jack L. Rau, Special Account".

2. The District Court erred in concluding as a matter of law that because the special account was created by petitioners and was held by Jack L. Rau as Trustee or agent of the bankrupt, and did not themselves own or acquire any other interest in said fund, appellants' counterdemand for an admitted indebtedness of the bankrupt to them is not allowable.

3. The District Court erred in holding that Jack L. Rau, the partner designated by appellants to hold the subject moneys in a special account as Trustee or agent of the bankrupt, did not acquire any other interest in said fund and that [119] therefore there is no mutuality of debts or credits as between the respective claims.

4. The District Court erred in holding that petitioners' right of setoff or counterclaim is not allowable under Section 68 (a) of the Bankruptcy Act.

5. Section 68 (a) of the Bankruptcy Act re-

quires that the prayer of the petition for an order allowing petitioners to setoff or counterclaim their undisputed demand against the bankrupt be granted since the Courts have given a broad construction to the words "mutual debts or mutual credits", not confining them to the ordinary "debtor and creditor" situation but extending their meaning to include money, property and even choses in action of the bankrupt held by the creditor.

6. The District Court erred in failing to hold that under Rule 13(b) of the Federal Rules of Civil Procedure (said rules being made applicable to bankruptcy by General Order in Bankruptcy No. 37 as amended) a pleading may state as a counterclaim any claim against an opposing party even though not arising out of the transaction or occurrence which is the subject matter of the opposing parties' claim, and in failing to hold that under said rule appellants' setoff or counterclaim for out-of-pocket expenses is assertable.

7. The District Court erred in failing to hold that a Bankruptcy Court is a court of equity applying equitable principles in the accomplishment of substantial justice and that under such principles appellants' setoff or counterclaim should be allowed.

Dated: March 8, 1956.

DESSER, RAU & HOFFMAN

/s/ By DAVID R. NISALL

Attorneys for petitioners - appellants. [120]

[Endorsed]: Filed March 9, 1956.

[Title of District Court and Cause.]

STIPULATION AS TO RECORD

It is Hereby stipulated and agreed by and between Desser, Rau & Hoffman (petitioners-appellants) and George T. Goggin, Esq., Trustee in bankruptcy of Stockholders Publishing Company, Inc., a bankrupt, (respondent-appellee) by their respective counsel that the following are designated as parts of the record and proceedings before the United States District Court for the Southern District of California, Central Division, to be included in the record on appeal to the United States Court of Appeals for the Ninth Circuit:

1. Petition of Desser, Rau & Hoffman to allow payment of expenses, filed January 21, 1955, together with Exhibit A to the petition, filed before Referee David B. Head.

2. Order of Referee David B. Head upon George T. Goggin as Receiver of the bankrupt to show cause why an order should not be entered pursuant to the prayer of said [121] petition dated and filed January 21, 1955.

3. Brief in support of petition to allow payment of expenses filed with said referee.

4. Trustee's memorandum in opposition to petition to allow payment of expenses, filed with said referee.

5. Reply to Trustee's memorandum in re petition to allow payment of expenses.

6. Memorandum of Referee David B. Head, filed

July 25, 1955, denying the petition to allow payment of expenses and ordering petitioners and Jack L. Rau, individually, to pay over to the Trustee in bankruptcy the amount held in the "Jack L. Rau, Special Account".

7. Findings of fact, conclusions of law and order of Referee David B. Head, entered and filed on August 17, 1955, ordering Desser, Rau & Hoffman and Jack L. Rau, individually, to pay over to George T. Goggin, Trustee, the sum of $3,217.68, being the amount held in the "Jack L. Rau, Special Account".

8. Petition for review of the order, findings and conclusions of Referee David B. Head by the United States District Court, filed August 26, 1955.

9. Points, authorities and brief on behalf of petitioners on petition for review by the United States District Court.

10. Trustee's memorandum of points and authorities in opposition to petition for review.

11. Reply of petitioners to Trustee's memorandum in opposition to petition for review.

12. Order of the United States District Court (Honorable Wm. M. Byrne) affirming the order of Referee David B. Head, dated August 17, 1955, and approving and adopting the findings of fact and conclusions of law [122] of said Referee.

13. Notice of appeal by petitioners-appellants, dated, served and filed January 31, 1956.

14. Bond or undertaking for costs on appeal in the sum of $250.00, executed by Fidelity and Deposit Company of Maryland.

Pursuant to the foregoing stipulation, the parties hereto respectfully request that the Clerk of the District Court of the United States for the Southern District of California, Central Division, under his hand and seal of the Court transmit to the Clerk of the United States Court of Appeals for the Ninth Circuit the matters so designated by the parties by such stipulation.

Dated: March 8, 1956.

DESSER, RAU & HOFFMAN
/s/ By DAVID R. NISALL
Attorneys for petitioners-appellants

ROBERT H. SHUTAN and CRAIG, WELLER & LAUGHARN
/s/ By ROBERT H. SHUTAN
Attorneys for respondent-appellee

[Endorsed]: Filed March 9, 1956.

[Title of District Court and Cause.]

CERTIFICATE BY CLERK

I, John A. Childress, Clerk of the United States District Court for the Southern District of California, do hereby certify that the foregoing pages numbered 1 to 123, inclusive, contain the original

Petition to Allow Payment of Expenses;

Order to Show Cause;

Trustee's Memorandum in Opposition to Petition to Allow Payment of Expenses;

Reply to Trustee's Memorandum in re Petition to Allow Payment of Expenses;

Brief in Support of Petition to Allow Payment of Expenses;

Memorandum by Referee;

Findings of Fact, Conclusions of Law & Order;

Petition for Review;

Petition for Review of Desser, Rau & Hoffman of Order of David B. Head, Referee;

Trustee's Memorandum of Points & Authorities in Opposition to Petition for Review;

Reply of Petitioners to Trustee's Memorandum in Opposition to Petition for Review;

Order Affirming Order of Referee;

Notice of Appeal;

Undertaking for Costs on Appeal;

Affidavit of David R. Nisall Stating that he has supervision of the appeal;

Order extending time to docket record on appeal;

Statement of Points to Be Relied on by Appellants;

Stipulation as to Record;

Which, in the above-entitled cause, constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in said cause.

I further certify that my fees for preparing the foregoing record amount to $2.00, which sum has been paid by appellants.

Witness my hand and the seal of said District Court, this 19th day of March, 1956.

[Seal] JOHN A. CHILDRESS,
Clerk

/s/ By CHARLES E. JONES,
Deputy

[Endorsed]: No. 15073. United States Court of Appeals for the Ninth Circuit. Desser, Rau & Hoffman, and Jack L. Rau, individually, Appellants, vs. George T. Goggin, Trustee in Bankruptcy of Stockholders Publishing Company, Inc., a bankrupt, Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed March 20, 1956.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 15073

DESSER, RAU & HOFFMAN, Appellants,

vs.

GEORGE T. GOGGIN, TRUSTEE,
Appellee.

ADOPTION OF APPELLANTS' STATEMENT OF POINTS AND DESIGNATION

Now come Desser, Rau & Hoffman, appellants in the above entitled cause by Desser & Hoffman, their attorneys, and hereby adopt the statement of points to be relied upon by appellants on appeal as contained in the typewritten transcript of record certified by the Clerk of the District Court of the United States for the Southern District of California, Central Division, and filed herein; and also hereby adopt the designation of the record as per stipulation of the parties, also filed herein as part of said typewritten transcript of the record, except that appellants are advised and informed by the Clerk of the United States Court of Appeals for the Ninth Circuit that briefs of the parties filed below are not printed by him although the Court may, if it wills, refer to them by consulting said typewritten transcript. Therefore, the following items appearing at their respective index pages in said typewritten transcript so certified and filed by said Clerk of the

United States District Court are not designated for printing:

Brief in Support of Petition to Allow Payment of Expenses—Typewritten Transcript—Page 29

Trustee's Memorandum in Opposition to Petition to Allow Payment of Expenses—Typewritten Transcript—Page 7

Reply to Trustee's Memorandum in re Petition to Allow Payment of Expenses—Typewritten Transcript—Page 12

Points and Authorities and Brief on Behalf of Petitioners—Typewritten Transcript—Page 66

Trustee's Memorandum of Points and Authorities in Opposition to Petition for Review—Typewritten Transcript—Page 98

Reply of Petitioner to Trustee's Memorandum in Opposition to Petition for Review — Typewritten Transcript—Page 103

Dated: March 28, 1956.

DESSER & HOFFMAN
/s/ By DAVID R. NISALL,
Attorneys for Appellants

Affidavit of Service by Mail attached.

[Endorsed]: Filed March 30, 1956. Paul P. O'Brien, Clerk.

No. 15073

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

DESSER, RAU & HOFFMAN and JACK L. RAU, individually,

Appellants,

vs.

GEORGE T. GOGGIN, trustee in bankruptcy of Stockholders Publishing Company, Inc., a bankrupt,

Appellee.

Appeal From the United States District Court for the Southern District of California, Central Division.

BRIEF FOR APPELLANTS.

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No. 15073

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Appellee.

Appeal From the United States District Court for the Southern District of California, Central Division.

BRIEF FOR APPELLANTS.

This is an appeal from the Order of District Court entered January 11, 1956, approving and affirming the Order of Referee in Bankruptcy, David B. Head, dated August 17, 1955, denying the petition of appellants, Desser, Rau & Hoffman, for an order allowing them to reimburse themselves for out-of-pocket expenses incurred on behalf of the Bankrupt prior to bankruptcy, from a special account created by appellants with funds of the now bankrupt corporation. The order appealed from also approved and adopted the Referee's Findings of Fact and Conclusions of Law. [Tr. 20.]

Statement Disclosing Basis of Jurisdiction.

The jurisdiction of the District Court of the Southern District of California, Central Division, is based upon *Section 1334, Title 28, U. S. C. (Chap. 85).*

The jurisdiction of the Court of Appeals for the Ninth Circuit is based upon *Sections 1291 and 1294, Title 28, U. S. C. (Chap. 83).*

The only pleading in the case is the petition of appellants, Desser, Rau & Hoffman, filed with and addressed to Referee David B. Head, in the matter of Stockholder's Publishing Company, Inc., then an alleged, and since an adjudicated bankrupt, which had done business in the City and County of Los Angeles, and the principal office and place of business of which was in said city and county. The petitioners prayed for leave to set off, retain and reimburse themselves out of funds in their hands belonging to the Bankrupt, the sum of $3,217.68, being actual out-of-pocket expense paid and advanced by petitioners as lawyers in connection with handling the legal affairs of the publishing company prior to bankruptcy. No answer to the petition was filed by the receiver or trustee in bankruptcy.

Statement of the Case.

On January 21, 1955 appellants filed their petition with Referee, David B. Head. The facts alleged were not controverted by answer, were not contradicted by countervailing evidence, are admitted by appellee, and are found as facts by the Referee. [Tr. 7.] Therefore it concededly appears that during the year prior to bankruptcy, from December, 1953, to December, 1954, appellants, in connection with their representation of the present bankrupt corporation, expended of their own funds the sum

of $3,217.68 for transportation and hotel accommodations and for long-distance telephone calls, which are itemized in Exhibit "A" to the petition. [Tr. 5.] The petition alleged, and it is not denied, that during the time petitioners represented the bankrupt they never billed it for fees or received any money from it for fees, and that the amount claimed did not represent any charge for fees for services.

On or about December 20, 1954, "for the purpose of protecting its incoming funds and making certain essential disbursement therefrom" [Finding III, Tr. 10], appellants, Desser, Rau & Hoffman, acting as attorneys for the company, and selecting one of their partners, Jack L. Rau, opened at Union Bank & Trust Company of Los Angeles a bank account designated as "Jack L. Rau, Special Account," in which funds of the publishing company were deposited and out of which disbursements were made. [Finding of Fact III, Tr. 10.]

Thereafter, on December 31, 1954, an Involuntary Petition in Bankruptcy was filed in the District Court against the company. Promptly on January 5, 1955, appellants rendered an accounting of receipts and disbursements to appellee George T. Goggin, then Receiver, showing the sum of $16,163.15 remaining in the Special Account, remitting the sum of $12,945.17 to the Receiver and retaining in said Special Account the sum of $3,217.68, the amount of their said out-of-pocket expense. [Findings IV, V and VI, Tr. 11.]

Appellants, on January 21, 1955, filed the instant petition setting forth the foregoing facts and praying that an order be entered authorizing them to reimburse themselves, out of said Special Account, their said cash advances on the Bankrupt's behalf in said sum of $3,217.68.

[Tr. 3-5.] On the same date the Referee issued an order requiring the Receiver (now Trustee in Bankruptcy and appellee herein) to show cause why an order should not be entered granting the prayer of the petition. [Tr. 5-6.]

Upon the return of the order to show cause no sworn testimony or other evidence was introduced, only informal, and perhaps argumentative, statements being made [Tr. 9], the Referee concluding that, from the face of appellants' petition, it appeared that appellants were not entitled to set off, counterclaim, or retain the amount requested in reimbursement of their cash expenditures. Permission to file briefs, however, was granted, and after the submission of written presentations of their respective positions by appellants and appellee, the Referee denied the prayer of the petition and ordered that appellants, the firm of Desser, Rau & Hoffman, and Jack L. Rau, individually, pay to appellee, George T. Goggin, as trustee, the sum of $3,217.68, the amount held in said Special Account. [Tr. 13.]

In his memorandum of July 25, 1955, which preceded entry of the order and the Findings of Fact and Conclusions of Law [Tr. 6], the Referee held that the facts set out in appellants' petition are admitted as true, but he decided that the prayer of the petition should be denied because a case of mutual debts or credits, such as contemplated by Section 68(a) of the Bankruptcy Act, was not presented. The Referee said:

> "It is clear to me that no mutuality of debts or credits are involved in this matter. Mr. Rau does not hold this fund as his own, but as trustee or agent of the bankrupt. He cannot and does not assert that this fund represents a debt of his to the bankrupt. In fact, the fund held by Mr. Rau is the property of the bankrupt." [Tr. 8.]

This, then, is the basis of the Referee's decision, and, while it seems to state a single and inseparable proposition, and to pose a single question, it found its way into two separate findings of fact and two conclusions of law. These are Findings of Fact VII and VIII and Conclusions of Law I and II.

Finding of Fact VII [Tr. 12] recites:

> "That Jack L. Rau held the moneys in such special account as Trustee or agent of the bankrupt corporation and said Jack L. Rau did not acquire any other interest in said fund."

Finding of Fact VII [Tr. 12] states:

> "That the moneys held by Jack L. Rau in the 'Jack L. Rau, special account' at the Union Bank and Trust Company of Los Angeles constitutes property of the bankrupt corporation."

From these findings the Referee arrived at his only two conclusions of law. Conclusion of Law I [Tr. 12] is as follows:

> "Jack L. Rau held the subject moneys in said special account as trustee or agent of the bankrupt corporation and did not acquire any other interest in said fund."

Conclusion of Law II [Tr. 12] is:

> "There is no mutuality of debts or credits between funds held by petitioners and the obligation of the bankrupt corporation for the funds advanced by petitioners. The funds held by Jack L. Rau on a special account constitute property of the bankrupt corporation."

Considering the Referee's memorandum decision [Tr. 8], together with his findings and conclusions, it would

appear, and it is respectfully so suggested, that the Referee (and, by approval and adoption, the District Court on review) actually held as one connected proposition that appellants' counterclaim should be denied because there is no mutuality of debts or credits between the obligation of the bankrupt to appellants for money expended, out of pocket, in the handling of the debtor's legal affairs, and the obligation to the bankrupt and its trustee to pay the entire balance in the special account without deduction, and that there is no such mutuality because Rau held the fund as trustee or agent, not acquiring any other interest therein, the said fund constituting property of the bankrupt corporation. Therefore, in the interests of clarity, this basic, single issue will be so treated in the ensuing specification of errors and in the argument.

The Referee stated in his memorandum opinion, also, that,

> "Before the moneys were turned over to Mr. Rau, his law partner, Mr. Desser, who was a director as well as counsel for the bankrupt corporation, had full knowledge of the insolvency of the bankrupt corporation. At a directors' meeting on December 18, 1954, in which Mr. Desser participated, the directors authorized the president of the bankrupt corporation to institute bankruptcy proceedings. If a transfer of this fund were permitted, it would date from December 20, 1954, or later. This would create a voidable preference under the provisions of Section 60(a) of the Bankruptcy Act." [Tr. 8.]

Appellee did not raise the question of avoidable preference, taking the position that the funds in the special

account never left the possession or ownership of the corporation and were not transferred or paid out to appellants or for appellants' use. This was probably the result of appellee's knowledge of the definition of avoidable preferences which contemplates, not a transfer for the debtor's own purposes, as in the case at bar, but a transfer to or for the benefit of a creditor for or an account of an antecedent debt, made while the debtor was insolvent and within four months before the filing of the petition in bankruptcy. Furthermore, the Referee did not follow his memorandum indicating the possibility of an avoidable preference by a finding or conclusion of law to such effect, nor did the District Judge express himself either expressly or impliedly on this subject, except by way of a blanket approval of the Referee's action.

While the order of the Referee of August 17, 1955 [Tr. 9-13], affirmed by the District Court on review by its order of January 11, 1956 [Tr. 19-20], from which this appeal is taken, and the definitive findings [VII and VIII] and the ultimate conclusions of law [I and II] are concerned only with the question of mutuality of debts or credits between the claim of the trustee for the return of the entire fund in the special account and the claim of appellants against the bankrupt and its trustee for out-of-pocket cash expenditures, nevertheless, for the purpose of completeness of presentation, the observation by the Referee on the subject of avoidable preference, will be discussed in this brief.

The main question presented for review is:

1. Does the fact that Jack L. Rau (the partner in the appellant firm designated to hold the funds in the special account by said firm) does not hold the fund as his own, but as trustee or agent of the debtor, and that said fund constitutes the debtor's, not Rau's, property or the property of the appellant firm, remove the case from the operation of Section 68(a) of the Bankruptcy Act which provides, in effect, that in all cases of mutual debts or mutual credits between the bankrupt estate and a creditor, one debt shall be set off against the other and the balance only be allowed and paid?

In other words, does the claim of the bankrupt or its trustee to the balance of the funds in the Jack L. Rau special account and the claim of appellants, Desser, Rau & Hoffman, for money theretofore expended in handling the debtor's legal business, constitute a situation of mutual debts or mutual credits within the meaning of Section 68(a) of the Bankruptcy Act?

In view of the comment of the Referee with respect to the possibility of an avoidable preference, the following question may be stated as ancillary to the foregoing main issue:

2. Would the allowance of appellants' admitted counterclaim for cash, out-of-pocket disbursements, from the funds held in the Jack L. Rau special account constitute a transfer of funds or the approval of a transfer of funds, which would create a voidable preference under Section 60(a) of the Bankruptcy Act?

Specification of Errors.

1. The District Court erred in holding that the claim of the bankrupt and its trustee to the balance of the funds in the "Jack L. Rau special account," and the claim of appellants, Desser, Rau & Hoffman, for money theretofore expended in handling the debtor's legal business, did not constitute a case of mutual debts or mutual credits within the meaning of Section 68(a) of the Bankruptcy Act.

The conclusion of the court was erroneous because the nature or character of the fund and the capacity in which it is held is not determinative of the right to set off or counterclaim. The conclusion is erroneous, moreover, because debts and credits may be "mutual" although the respective causes of action are dissimilar and even though the claim of the bankrupt against its creditor may arise out of a trust or agency relationship in which the counterclaiming creditor holds property, funds or even choses in action of the bankrupt.

2. The Court erred in holding that the allowance of appellants' counterclaim for admitted cash disbursements made on behalf of the bankrupt during the year preceding its bankruptcy, out of funds held in the special account would constitute a transfer, or the approval of a transfer, of funds which would create a voidable preference under Section 60(a) of the Bankruptcy Act.

This general conclusion or observation of the Referee is erroneous because the transfer of funds of the bankrupt to appellants, who created the special account in the name of one of the partners, Jack L. Rau, was not a transfer to or for the benefit of appellants, for or on account of an antecedent debt, as provided in Section 60(a) of the Bankruptcy Act.

Summary of the Argument.

I.

THE CLAIM OF THE BANKRUPT AND ITS TRUSTEE AGAINST APPELLANTS FOR THE PAYMENT AND RETURN OF THE BALANCE OF THE FUNDS IN THE SPECIAL ACCOUNT, AND THE COUNTERCLAIM OF APPELLANTS AGAINST THE BANKRUPT AND ITS TRUSTEE FOR OUT-OF-POCKET EXPENDITURES OF CASH BY APPELLANTS ON THE BANKRUPT'S BEHALF, PRESENTS A CASE OF MUTUAL DEBTS AND MUTUAL CREDITS WITHIN THE MEANING OF SECTION 68(a) OF THE BANKRUPTCY ACT. (TITLE 11, U. S. C. A., SEC. 108(a).)

It is admitted that at the time of the filing of the petition in bankruptcy appellants owed the bankrupt the balance in a special fund created by appellants and placed in the name of one of the appellants' partners, as counsel for the bankrupt, and that, at said time, the bankrupt owed appellants a lesser sum for actual out-of-pocket expense incurred in the handling of the debtor's legal business.

A.

The ultimate ownership by the bankrupt of a fund or property in the hands of one who is also a creditor of the bankrupt, or the nature of the liability or accountability to the bankrupt for the delivery or redelivery thereof, is not determinative of the right to set off or counterclaim for such indebtednes of the bankrupt as against the fund or property of the bankrupt so in the creditor's possession.

Section 68(a) of the Bankruptcy Act provides:

> "In all cases of mutual debts or mutual credits between the estate of the bankrupt and a creditor, the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

The District Court's ruling that because the fund was held in a trust or agency capacity and constituted the property of the bankrupt, and the bankrupt's indebtedness to appellants was for cash advances previously made,

there was no mutuality of debts or credits, was erroneous because under the authorities, including a controlling decision by this court (*Half Moon Fruit and Produce Co. v. Floyd,* 60 F. 2d 799) it is settled that where a creditor has funds, goods or even choses in action placed in his hands before bankruptcy, a case of mutual debts and credits arises within the meaning of the Bankruptcy Act, to which the doctrine of set-off is applicable.

The courts give a broad construction to the phrase "mutual debts or mutual credits," not confining the doctrine of set-off to identical or similar pecuniary demands, by extending it to all cases where the creditor, who is also a debtor of the bankrupt, has property of the debtor in his hands which cannot "be got at" without an action at law or a proceeding in equity.

B.

Federal Rules of Civil Procedure furnish additional support for appellants' contentions as to the propriety of the allowance of their set-off or counterclaim against the demand of the trustee for the payment of the balance of funds in the special account, because bankruptcy courts proceed under the Federal Rules of Civil Procedure which now specifically authorize set-offs and counterclaims even where not arising out of the same transaction and even where the respective claims are completely different in nature and in substance and in the form of the remedy.

Under General Order No. 37 in Bankruptcy, as amended, Federal Rules of Civil Procedure must be followed in bankruptcy proceedings where not inconsistent with the Bankruptcy Act or with General Orders in Bankruptcy.

Rule 13, Federal Rules of Civil Procedure, provides that any claim may be stated as a counterclaim even

though not arising out of the same transaction or occurrence.

This rule is given the most liberal construction by the courts, following its legislative history which discloses that all claims and counterclaims of the parties, no matter how dissimilar in theory or in the nature of the relief, should be determined in a single proceeding.

Rule 13 should be construed together and in harmony with Rule 42(a), Federal Rules of Civil Procedure, which provides for a consolidation of actions.

II.

THE TRANSFER OF FUNDS WITHIN FOUR MONTHS PRIOR TO BANKRUPTCY, BY THE BANKRUPT TO APPELLANTS, DESSER, RAU & HOFFMAN, TO CREATE A SPECIAL ACCOUNT OUT OF WHICH TO PAY CERTAIN OF ITS OBLIGATIONS, WAS NOT AN AVOIDABLE PREFERENCE, AND THE RECOGNITION BY THE COURT OF APPELLANTS' RIGHT TO SET OFF THE BANKRUPT'S INDEBTEDNESS TO THEM AS AGAINST THE BALANCE OF THE FUND EXISTING AT THE TIME OF THE FILING OF THE PETITION IN BANKRUPTCY, WOULD NOT GIVE TO THE AMOUNT SET OFF THE CHARACTER OF AN AVOIDABLE PREFERENCE.

Although the Referee did not find or conclude, in his formal findings of fact and conclusions of law, that the transfer to appellants of funds of the bankrupt with which appellants created the special account constituted, or would, if allowed, constitute an avoidable preference, he did indicate his views on this subject as a matter of law, stating that the *time* of the creation of the special account was, in effect, determinative of the fact that, if the transfer of the bankrupt's funds to appellants were permitted, it would be dated at a time within four months of the filing of the petition in bankruptcy and hence would be an avoidable preference under Section 60(a) of the Bankruptcy Act.

In this the Referee was in error because, under Section 60(a) the time of the transfer is only important if the transfer itself comes within the definition of avoidable preferences.

Section 60(a) defines an avoidable preference as a transfer of property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent, and within four months of the filing of the petition in bankruptcy.

The transfer of the bankrupt's funds into the special account, for its own purposes, was not a transfer to appellants for appellants' benefit for or on account of an antecedent debt of the bankrupt to them.

The special fund was created by a transfer to appellants in the course of the handling of the bankrupt's legal business, and under such circumstances did not constitute, according to the authorities, an avoidable preference.

All preferences are not avoidable and are not *malum prohibitum,* being avoidable only if they come clearly within the prohibition of the Bankruptcy Act.

The trustee in bankrucpty has the burden of proving that the payment or transfer of the debtor's funds or property is an avoidable preference within the strict definition of the Bankruptcy Act.

The trustee failed to make such proof in the present case.

The deduction of the amount of their out-of-pocket expense by appellants from the special fund would be merely the accomplishment of a mutual set-off under the pro-

visions of Section 68(a) of the Bankruptcy Act. The net estate of each remained the same.

The fact that the allowance of the set-off or counterclaim would result in appellants receiving more than their pro rata share of their claim against the bankrupt, as compared with other creditors, does not constitute any reason for disallowance.

The Supreme Court of the United States has held that the real mischief which the Bankruptcy Act purposes to prevent is the acquiring of claims against the bankrupt, when, within four months, it is known to be in financial trouble, for use by way of set-off and reduction of indebtedness to the bankrupt estate. (229 U. S. 138.) The instant situation presents no such problem.

CONCLUSION.

The claim of the bankrupt and its trustee for the payment and return of the funds in the special account and the claim of appellants against the bankrupt for expenses incurred while handling the bankrupt's legal business, constitute a situation of mutual debts and mutual credits, each being indebted to the other in a fixed and liquidated sum of money. Since an avoidable preference cannot be said to exist, appellants are entitled to set-off and counterclaim their demand as against their obligation to the bankrupt under the Bankruptcy Act, under the Federal Rules of Civil Procedure, under the authorities, and in accordance with equity and good conscience.

ARGUMENT.

I.

The Claim of the Bankrupt and Its Trustee Against Appellants for the Payment and Return of the Balance of the Funds in the Special Account, and the Counterclaim of Appellants Against the Bankrupt and Its Trustee for Out-of-pocket Expenditures of Cash by Appellants on the Bankrupt's Behalf, Presents a Case of Mutual Debts and Mutual Credits Within the Meaning of Section 68(a) of the Bankruptcy Act. (Title 11, U. S. C. A., Sec. 108(a).)

As a preface to this argument it may be helpful to restate important record admissions affecting appellants' position.

It is admitted that appellants have, and at the time of, and prior to the filing of the petition in bankruptcy herein had, a just claim against the corporation in the definite sum of $3,217.68, due to them, not as fees for services, but for actual outlays of cash in the handling of the debtor's affairs. Appellants have never billed or charged for their services.

It is admitted that the funds delivered to appellants and deposited in the special account were not paid to appellants or to Jack L. Rau, as their designee, for appellants' benefit on account of any antecedent debt of the corporation to them.

It is admitted that the cash deposits made into the special account were made for the purpose of disbursement on behalf of the corporation and that such special ac-

count was created in the course of handling the corporation's affairs by appellants as its counsel.

It is admitted that disbursements for corporate purposes were made, that involuntary bankruptcy intervened which put an end to the use of the fund for which it was designed, that a balance then remained in the account in the sum of $16,163.15, and that an accounting with a check in the sum of $12,945.45 was immediately delivered to the receiver, thus deducting the sum of $3,217.68 pending a determination by the court of appellants' right to off-set this amount of out-of-pocket expense as against the balance in the fund.

A.

The Ultimate Ownership by the Bankrupt of a Fund or Property in the Hands of One Who Is Also a Creditor of the Bankrupt, or the Nature of the Liability or Accountability to the Bankrupt for the Delivery or Redelivery Thereof, Is Not Determinative of the Right to Set Off or Counterclaim for Such Indebtedness of the Bankrupt as Against the Fund or Property of the Bankrupt so in the Creditor's Possession.

Section 68(a) of the Bankruptcy Act provides:

> "In all cases of mutual debts or mutual credits between the estate of the bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid." (Title 11, U. S. C. A., Sec. 108, p. 535.)

The Referee concluded, and the District Court on petition for review agreed, that appellants' counterclaim was not allowable under Section 68(a) because Jack L. Rau did not hold the fund "as his own," but as trustee or agent of the bankrupt, and that, in fact, the fund held

by Rau "is the property of the bankrupt." For these reasons it was held that "no mutuality of debts or credits are involved in this matter." [Tr. 8.]

If, of course, Jack L. Rau held the fund "as his own," this case would not be before the court. It is his and the appellant firm's obligation to the bankrupt to account for and repay the unused balance that gives rise to the presence of the counterclaim. Certainly appellants owed to the bankrupt the obligation to turn over funds remaining in the special account. Certainly, also, the bankrupt, simultaneously, owed to appellants the obligation to pay to them their out-of-pocket expenditures on its behalf. Both are simple claims for liquidated amounts of money.

Had bankrupcty not intervened, the situation would present (1) a claim by the corporation for the return of the balance enforceable by a suit for an accounting and a decree for the amount due, and (2) a claim at law by appellants for money expended enforceable by suit at law and a judgment therefor. In such case both claims could be heard, decided and adjusted in one lawsuit, clear right to urge their demand by way of counterclaim being granted to appellants as will be seen by the Federal Rules of Civil Procedure. Each party owing the other a sum of money, they are "mutually" indebted.

The court below, however, took the view that since Rau, in whose name the account stood and who made authorized disbursements therefrom prior to bankruptcy, did not himself personally own the fund and had title to it only as trustee or agent for the publishing company, the counterclaim claim of appellants, who created the special account, could not be allowed. That it was appellants who did so create the special account in the name of their

partner is found as a fact by the court below. Finding III recites:

> "That for said purpose, on December 20, 1954, the petitioners, Desser, Rau and Hoffman, acting as attorneys for the bankrupt corporation, opened at the Union Bank and Trust Company of Los Angeles, a bank account designated as 'Jack L. Rau, special account.'" [Tr. 10-11.]

In effect, therefore, the court below concluded that the equitable ownership of the fund by the bankrupt, the trust or agency capacity in which it was held and, above all, the fact that the account was property of the corporation, insulated the fund from any claim by the holder no matter how just and indisputable.

There is nothing in the law of bankruptcy which makes these mutual obligations unmutual. On the contrary, there are many instances where assets, acknowledged property of the bankrupt, were in the hands of creditors of bankrupt who are also its debtors at the time of bankruptcy, who were allowed to set off their claims as against property and funds of the bankrupt then in such creditors' hands.

A case which seems determinative of the question was decided by this court, which held that actual ownership by the bankrupt of goods held under consignment by a creditor, does not operate to preclude the right of set-off under Section 68(a) of the Bankruptcy Act.

In *Half Moon Fruit and Produce Co. v. Floyd,* 60 F. 2d 799 (C. C. A. 9), it appeared that a producer-grower, shortly before bankruptcy, consigned melons to a commission merchant who had made previous and independent advances to the grower for which the bankrupt was indebted to the commission merchant. Judge Wilbur, who

rendered the opinion of the court, held that this was a situation of mutual credit which entitled the commisison merchant to set off his independent claim which was in no manner connected with the consignment of the goods in question. In reversing the order of the Referee which was confirmed on other grounds by the District Judge, this court, after quoting Section 68(a) of the Bankruptcy Act, said at page 801:

> "This provision of the statute, borrowed from the English Bankruptcy Act, asserts a broader right of setoff than is usual *because of the broad significance given to the phrase 'mutual credits.'* (Emphasis supplied.) See *Rose v. Hart,* 8 Taunt. 490; *Cullen v. Foster,* 5 Fed. Cas. 305, No. 2519. The rule contended for by Appellant seems to be sustained by the authorities cited. Appellant states: 'It is well settled that where a creditor has goods or choses in action placed in his hands before the bankruptcy under such circumstances that the deposit will result in a debt, as if they are deposited for sale and collection, a case of mutual credit arises within the meaning of the Bankruptcy Act to which the doctrine of setoff is applicable.'"

Speaking further, the court said at page 802:

> "In Murray v. Riggs, 15 Johns. (N. Y.) 571, 592, the court, in dealing with the question of setoff in bankruptcy cases said 'That mutual credit was not confined to pecuniary demands, *but extended to all cases where the creditor had goods in his hands of the debtor and which could not be got at without an action at law or bill in equity.'"* (Emphasis supplied.)

This court then considered the case of *Goodrich v. Dobson,* 30 Fed. Cas. No. 18279, page 1081, where a

manufacturer of cloth consigned goods to a New York merchant for sale. In approving that opinion the court said:

> "The property was sold after the bankruptcy and the amount derived therefrom applied upon an outstanding indebtedness owed by the manufacturer to the merchant."

It may be noted that the commission merchant in the *Half Moon* case and the merchant in the *Goodrich* case, by the fortunate circumstance that they held property of the debtor, actually received a preference, but not an avoidable preference. Such creditors are allowed to retain the advantage of their position because their possession of the property of the bankrupt did not come within the definition of avoidable preferences under the Bankruptcy Act.

The "broad significance" mentioned by the court given to the phrase, "mutual credit," is exemplified by *In re W. & A. Bacon Co.,* 261 Fed. 109, 111 (D. C., Mass.). There the creditor had a claim for services in delivering parcels for the bankrupt store prior to bankruptcy. The practice had been for the creditor to pay over the sums collected upon the delivery of the packages every few days. At the time of the bankruptcy the creditor had a sum of money in his hands received as payment for goods delivered for the bankrupt to the bankrupt's customers. The court sustained the creditor in its claim of right to apply such proceeds to the bankrupt's indebtedness. In the *Bacon* case, certainly, the packages delivered to the delivery service were the property of the bankrupt and the funds derived from payments by the customers who received such packages were also property of the bankrupt.

In *Fidelity and Deposit Co. of Maryland v. Duke,* 293 Fed. 661, 665 (C. C. A. 9), the case involved the right of a surety to set off a debt incurred under a contract of suretyship, the debt arising from the fact that the surety had made a payment to the County Treasurer on the bank's default after liquidation had commenced. While this case involved a bank liquidation, it is interesting in its implications. The court said that the rules respecting set-offs and counterclaims were "meritorious and far-reaching" in the adjustment of mutual accounts. "Doubtless it will be conceded," said the court, "that setoff does not depend upon the variety of the contract or the character of the parties."

In considering what are "mutual debts or mutual credits' between the bankrupt estate and the creditor, the court, in *In re Field Heating and Ventilating Co.,* 201 F. 2d 316 (C. C. A. 7), said at page 318:

> "The yardstick for the determination of the right of set-off in bankruptcy is whether the debts are mutual, *that is, whether each owes the other,* and if such reciprocal demand exists, one may be set off against the other, *no matter whether insolvency is present or whether set-off is made before or after bankruptcy intervenes,* for, if the parties have not voluntarily effectuated a set-off prior to bankruptcy, it is the duty of the trustee to do so." (Emphasis supplied.)

The court said also at page 318:

> "As we view the record only one material issue is presented and that is whether the events related bring claimant within the protective provisions of Section 68(a), which provides that 'in all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor, the account shall be stated

and one debt shall be set off against the other, and the balance only shall be allowed and paid.' We keep in mind that to justify set-off it is not necesary that the debts be of the same *character;* claims of *different species* may be set off, if they are mutual." (Emphasis supplied.)

In *In re Rosenbaum Grain Co.,* 103 F. 2d 656 (C. C. A. 7), the court said at page 659:

"The trustee, who has perfected his appeal from the allowance order bases his assignment of errors on the proposition that the obligations or claims in question are not mutual. He contends that the relationship between a stockbroker and his customer is one of pledgee-pledgor, whereas the relationship between the grainbroker and his customers is simply one of creditor-debtor . . . He concludes therefore that the obligations, not owing in the same capacities, are not 'mutual debts or credits.'"

The court, disagreeing with the trustee's contentions, said at page 662:

"We have given serious attention to appellant's brief. To heed the argument made there, in our opinion is to prize form above substance. To argue that the applicability of Section 68(a) of the Bankruptcy Act is dependent upon a possible distinction of a pledge of stock certificates as security and a holding of grain contracts as security is to adhere unnecessarily to technicality. The District Court's order allowing a set-off of the respective obligations is affirmed."

In a footnote to the *Rosenbaum Grain Co.* case appears the following observation:

"In our problem equitable considerations carry great weight."

If equitable considerations are to be given any weight in the case at bar, then, in view of the fact that appellants have made no claim and intend to make no claim for services rendered during the critical year preceding bankruptcy, in the effort to preserve the corporation for its creditors as well as its owners, it would seem that the court should not strain to deny appellants' prayer.

In a single sentence from the opinion in *Studley v. Boylstone National Bank,* 229 U. S. 523, the court indicated the realistic and equitable approach to the claim of the right of set-off. The court said:

> "Such counter claims can be asserted as a defense or as a voluntary act of the parties, because it is grounded upon the absurdity of making A pay B when B owes A."

A court of bankruptcy inquires, what in justice and equity should be done and may be done under applicable principles, to satisfy ordinary rules of fair play. As the court said in *First Naitonal Bank v. Malone,* 76 F. 2d 251, 254 (C. C. A. 8), a set-off is allowed "upon the theory that in good conscience one ought not to pay his creditor if he cannot ultimately compel his creditor to pay the debt due to him."

It is apparent from the authorities that the controlling factor in cases involving the question here presented is that the bankrupt is actually indebted to the creditor, not the technical nature of such indebtedness or of the property in the creditor's hands as to which the creditor attempts to assert a counterclaim. Under the decisions, "mutual debts or mutual credits" means "mutual obligations," that is to say, obligations of each, respectively, to the other. The word "mutual" does not mean identical in character or identical in obligation or enforceable by identical means.

If the bankrupt, prior to bankruptcy, possess claims and demands against others, such claims and demands may be pursued by the trustee either in the bankruptcy court, or, when necessary, by plenary action. If there be defenses to such claims they are assertible against the trustee and it makes no difference whether such defenses be by way of traverse or set-off or counterclaim,—they are equally available. The intervention of bankruptcy works no change in the fundamental rights of the parties beyond the express provisions of the Bankruptcy Act itself.

The "Jack L. Rau special account," to the extent possible prior to bankruptcy, had served its purpose. The undisbursed balance belongs in the general assets of the corporation as part of the bankrupt estate. It was not earmarked for any particular creditor or creditors or for any particular purpose. Had bankruptcy not occurred and had the purpose of the account been fulfilled, leaving a balance, any demand of the corporation for the payment of the remainder could, under the authorities, be reduced by the amount of the debt owed to appellants by the corporation, which could be asserted either by independent action or by set-off or counterclaim. The demand for the balance by the corporation would not, in such case, be predicated on the effort to preserve and continue the special purpose of the original account, but, rather, upon the effort to obtain the amount remaining for use in the general conduct of the corporation's financial affairs and as a part of its general assets. The trustee in bankruptcy stands in the same position. The intervention of bankruptcy does not change the meaning of the words "mutual debts or mutual credits" as that phrase has been interpreted by this and other courts.

B.

Federal Rules of Civil Procedure Furnish Additional Support for Appellants' Contentions as to the Propriety of the Allowance of Their Set-off or Counterclaim Against the Demand of the Trustee for the Payment of the Balance of Funds in the Special Account, Because Bankruptcy Courts Proceed Under the Federal Rules of Civil Procedure Which Now Specifically Authorize Set-offs and Counterclaims Even Where Not Arising Out of the Same Transaction and Even Where the Respective Claims are Completely Different in Nature and in Substance and in the form of the Remedy.

The fact that Rau held the fund as trustee or agent for the bankrupt and not as his own disturbed the Referee to the point that he found it impossible to consider the trustee's claim for the return of the balance in the fund and appellants' claim for reimbursement, in the same proceeding.

The treatment of counter demands is one of the subjects where traditional views as to procedural requirements have yielded to substance and simplicity. It is believed that modern rules of federal procedure have distinct relevance in the consideration of this appeal. Under general order No. 37 in Bankruptcy, as amended by the Supreme Court of the United States on January 16, 1939, it is provided that in proceedings under the Bankruptcy Act the rules of Civil Procedure shall, insofar as they are not inconsistent with the Act itself or with General Orders in Bankruptcy, be followed.

Rule 13 of the Federal Rules of Civil Procedure had the effect of still further broadening the already liberal interpretation given to Section 68(a) of the Bankruptcy Act by the courts. Under Rule 13, all semblance of the older technical requirements, all of the rules and dicta respect-

ing the nature or special character of the indebtedness or indebtednesses as to which there are claims and counterclaims, are swept away in the interests of substantial, quick and economical justice. The rule provides for two kinds of set-offs or counterclaims, compulsory and permissive. Under subdivision (a) of Rule 13, "A pleading *shall* state as a counterclaim any claim which at the time of serving of the pleading the pleader has against any opposing party, *if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim* . . ." Under subdivision (b) the provision here applicable, "A pleading *may* state as a counterclaim *any claim* against an opposing party *not arising out of the transaction or occurrence* that is the subject matter of the opposing party's claim." (Emphasis supplied.)

The liberality of Rule 13 is manifest from the language of all of its divisions. For example, in subdivision (c) a counterclaim may or may not diminish or defeat recovery and it may claim relief "exceeding in amount or different in kind from that sought by the pleading of the opposing party." Subdivision (e) provides that a counterclaim may be asserted "which either matured or was acquired by the pleader after serving his pleading," with permission of the court. Subdivision (f) allows a defendant, by leave of court, to take advantage of a permissive counterclaim, even where he fails to set it up through oversight, inadvertence or excusable neglect "or when justice requires."

The legislative history of Rule 13, has notably influenced the decisions. Such history reveals an almost limitless breadth of liberality. The extent to which the courts go in allowing set-offs and counterclaims is indicated by such decisions as *Kuenzel v. Union Carloading Co.*, 29 Fed. Supp. 407 (D. C. E. D. Pa.), where a set-off

or counterclaim *for goods sold and delivered* was allowed to be interposed *in an action for libel.* The court quoted a discussion of the rule appearing in a Report of the Proceedings of the American Bar Association Institute on Federal Rules (p. 409):

> "Mr. J. R. Keaton (Oklahoma City) Does that mean that if A should sue B for tort, an automobile accident we will say, that B may come back with a promissory note and adjust in the same suit?
>
> Mr. Clark: (Dean Charles Clark of Yale University Law School, Institute lecturer): It certainly does.
>
> Mr. Keaton: All of the claims, whether involving a contract or a tort can be settled in the same suit?
>
> Mr. Clark: Yes."

The court, in the *Kuenzel* case, went on to say:

> "The language of the rule and the above stated interpretation thereof leave no doubt that its effect, meaning and intent permit counterclaiming such as involved in the instant suit . . ."

A further reference to the views of Dean Clark in his discussion of the Rule in the proceedings of the Institute, appears in *Warren v. The Indiana Refining Co.,* 30 Fed. Supp. 281 (D. C. Ind.), where the court said at page 282:

> "The reason given by the very learned members of the committee that drafted the rules for allowing such wide latitude on the subject of counterclaims is expressed by Dean (now Judge) Clark at the Institute held in Washington on Federal Rules of Procedure, as follows, 'that all points of difference between the parties or spots of irritation between the parties should be brought out in the open and should

be fought over and disposed of at one time', is quite persuasive."

The Supreme Court of the United States, in *Chicago Northwestern Railway Company v. Lindell,* 281 U. S. 14, said at page 17:

> "The adjustment of defendant's demand by counterclaim in plaintiff's action rather than by independent suit is favored and encouraged by law. That practice serves to avoid circuity of action, inconvenience, expense, consumption of the court's time, and injustice."

The District Court of the United States for the Northern District of California, in *Pennsylvania Railway Co. v. Musante-Phillips, Inc.*, 42 Fed. Supp. 340, 342 (while the matter before it involved a compulsory counterclaim), expressed complete concurrence with the modern legal view as to set-offs and counterclaims as expressed by the Supreme Court in the United States.

All of the modern decisions considering Rule 13 confirm its wide scope and purpose, freeing litigants from former rules requiring set-offs and counterclaims to arise out of the same transaction, restricting the use of such counter pleading to cases requiring similar relief, and dividing legal from equitable claims.*

Were independent proceedings filed, one by the publishing company for an accounting and return of the unused balance in the special account, and the other by appellants

---

*Interesting discussions as to the wide scope and purpose of Rule 13 appear in "Proceedings of American Bar Association Institute" held in Cleveland, page 247; Moore's Federal Practice Volume 1, page 645; Notes of the Advisory Committee on Rules, Title 28 U. S. C. A., page 514, and 25 Virginia Law Review 261. A collection of cases dealing with this subject appears in the Appendix to this brief.

for a money judgment in the amount of their out-of-pocket expenditures, the two cases could, and probably would be, consolidated for the purpose of conserving the time of the court.

Rule 42(a) of the Federal Rules of Civil Procedure provides:

> "When actions involving a common question of law or fact are pending before the court, it may order a joint hearing or trial of any or all the matters in issue in the action; it may order all the actions consolidated; and it may make such orders concerning proceedings therein as may tend to avoid unnecessary costs or delay."

In *Prudential Insurance Co. of America v. Saxe,* 134 Fed. 2d 16, 34 (C. A. Dist. Col.) (cert. den. 319 U. S. 745), it was held that Rule 13 should be construed in harmony with Rule 42 giving the District Court broad discretionary powers for the consolidation of actions involving a common question of law or fact. Certainly appellants' rights to recover out-of-pocket expenditures for the corporation is common to both an action for an accounting and an independent suit for money judgment.

Under the current treatment of set-offs and counterclaims, allowing equitable claims to be set-off against legal demands and vice versa, it would seem that the capacity in which appellants acted with respect to the Jack L. Rau special account, and the capacity in which Jack L. Rau himself acted and the fact that the funds in the special account constituted property of the corporation, are not of controlling significance and present no technical barrier to the successful assertion by appellants of their counter demand or to the deduction of the amount thereof from the funds held in the special account. The court below erred in holding to the contrary.

II.

The Transfer of Funds Within Four Months Prior to Bankruptcy, by the Bankrupt to Appellants, Desser, Rau and Hoffman, to Create a Special Account Out of Which to Pay Certain of Its Obligations, Was Not an Avoidable Preference, and the Recognition by the Court of Appellants' Right to Set Off the Bankrupt's Indebtedness to Them as Against the Balance of the Fund Existing at the Time of the Filing of the Petition in Bankruptcy, Would Not Give to the Amount Set Off the Character of an Avoidable Preference.

There is irreconcilable inconsistency between the idea that the fund as against which appellants seek to set off their claim was and remained the property of the bankrupt which was not nor was any part thereof ever transferred to appellants in such manner as would confer upon them or their agent, Rau, any personal interest or individual right, and the idea that such transfer was a preferential payment to appellants avoidable under Section 60(a) of the Bankruptcy Act.

The trustee took the position, which the court below approved, that the corporation did not transfer the fund to the appellant firm or to Rau, their designee, and the account never lost its character as the property of the bankrupt. If this be true, then there could be no preference avoidable under the Bankruptcy Act. As has been seen, the fact that the fund was the property of the bankrupt does not prevent a set-off or counterclaim against it. It was, perhaps, in partial recognition of the soundness of appellants' contentions in this respect that impelled the Referee to insert in his memorandum his observation with respect to avoidable preferences. And the evident reason for this statement by the Referee was the lateness

of the date at which the fund was given to appellants to create the special account. In his opinion the Referee said [Tr. 8], "If a transfer of this fund were permitted, it would date from December 20, 1954, or later. This would create a voidable preference under the provisions of Section 60(a) of the Bankruptcy Act."

It should be observed, however, that the *date of the transfer* is only important if the transfer itself comes within the purview of the statute, *i. e., a transfer to or for the benefit of the creditor for or on account of an antecedent debt.* The popular impression that *any* transfer of funds or property by an insolvent debtor within four months of the filing of the petition in bankruptcy is an unlawful preference, seems to have sometimes permeated the thinking of referees, trustees and even District Courts. But the commendatory effort to build up and preserve assets of the general estate for the benefit of general creditors (which incidentally has a direct bearing upon the size of allowable fees) does not justify a departure of the plain meaning of a statute or from sound principle. The purpose of the bankruptcy courts, in situations where the bankrupt occupies the position of both creditor and debtor to another, is to obtain for the estate the net balance, if any, due to or from the bankrupt.

Here appellants, and Jack L. Rau, their designee, at the time of intervention in bankruptcy, owed the bankrupt $16,163.15. Whether they owed this amount as an ordinary debtor or as trustee or agent makes no difference under the authorities cited under Point I above. At the same time the bankrupt owed appellants the sum of $3,217.68. The net balance due to the bankrupt was $12,945.47 which was remitted to the receiver. The net balance as it existed at the time of bankruptcy will not

be disturbed unless the bankrupt, by transferring funds to the special account, can be said to have preferred appellants unlawfully in so doing. The element of deliberate preferential treatment, essential to condemning a transfer by the debtor to its creditor as an unlawful and avoidable preference, is wanting.

In the vast majority of cases wherein the creditor is regarded as having been illegally preferred, such creditor occupied the position of creditor only, owing nothing to the bankrupt. Whether or not the transfer of funds to appellants to create the special account, or the subsequent deductions of the amount of the counterclaim (as to which the debtor did not participate) can be said to constitute an avoidable preference depends upon the language of Section 60(a) of the Bankruptcy Act. This section provides:

> "A preference is a transfer, as defined in this title, of any property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent, and within four months before the filing by or against him of the petition in bankruptcy. . . ." (Sec. 60(a) of the Bankruptcy Act is Title II, Sec. 96(a), U. S. C. A.)

The only restriction upon the right to present a set-off or counterclaim as against a trustee in bankruptcy is that such set-off or counterclaim will be disallowed only when not provable against the estate and allowable under subdivision (g) of Section 57 of the Bankruptcy Act. (Title II, Sec. 93(g), U. S. C. A.) This section provides:

> "The claims of creditors who have received or acquired preferences, liens, conveyances, transfers,

assignments or encumbrances, void or voidable under this title, shall not be allowed unless such creditors shall surrender such preferences, liens, conveyances, transfers, assignments, or encumbrances."

Turning to Section 60(a) of the Bankruptcy Act wherein the definition of avoidable preference is found, we have seen that a preference, to be an avoidable preference, must be a transfer of the property of a debtor "to or for the benefit of a creditor for or on account of an antecedent debt." It is, under Section 60(b), as to *"any such preference"* that the knowledge of insolvency becomes relevant.

Under the admitted facts the transfer of funds by the bankrupt to the appellant firm, who created the Jack L. Rau special account, did not come within the purview of an avoidable preference as defined by the act. The funds in the special account were not transferred to appellants or to one of their partners, Jack L. Rau, "to or for their benefit" as creditors, or "for or on account of an antecedent debt" due to them. The fund was created in the course of business of the debtor corporation to be administered by appellants for the corporation's benefit and disbursed upon its obligations.

Whether or not a transfer or payment by a debtor constitutes a voidable preference must be determined as of the time of such transfer or payment, not by events occurring after bankruptcy. The question is, were the deposits in the special account, at the time they were deposited, made to or for the benefit of appellants for or on account of an antecedent debt due from the bankrupt to them? The funds and the deposits in the fund are not claimed by appellants as a payment to or for them or

upon an antecedent debt due to them. Their position is that, having lawful possession when the petition in bankruptcy was filed of a balance of the fund originally delivered to them for corporate purposes, which balance constituted a claim against them for its return, they have a concomitant right of set-off for the amount due to them. Any advantage they may have received arises, not from a preferential payment or advance to them, but from the right to set off their claim, a right especially conferred by the Act when bankruptcy intervenes. In effect, the set-off provision of the Bankruptcy Act merely preserves, after bankruptcy, the rights and liabilities *inter se* which existed prior to bankruptcy. The fund was created in the course of handling the legal business of the debtor corporation, to be administered by appellants through Jack L. Rau, their partner, for the client's benefit and disbursed on its obligations.

Preferences are not *malum prohibitum* and are voidable only when they come within the express prohibitions of the statute. In 8 Corpus Juris Secundum, Section 213, page 696, it is said:

> "In view of the fact that, at common law and in the absence of statutory prohibition, an insolvent debtor has the right to prefer one creditor over others, a trustee in bankruptcy must derive from some provision of the Bankruptcy Act whatever right he may have to avoid an alleged preference by the bankrupt. A preference is *malum prohibitum* only to the extent that it is prohibited by the Act."

To the same effect are *Von Iderstine v. National Discount Co.,* 227 U. S. 575, 582; *Coleman v. Potter Title and Trust Co.,* 4 Fed. Supp. 743, 744 (D. C. W. D. Pa.).

In claiming a preference the trustee in bankruptcy has the burden of proving that the payment or transfer of the debtor's funds or the transfer of the debtor's property is an avoidable preference within the strict definition of the Act.

In *Barry v. Crancer,* 192 F. 2d 939 (C. C. A. 8), the court said:

> "We know of no holding and we do not understand that appellant (the trustee in bankruptcy) contends that the action under 11 U. S. C. A., Sec. 96, Subdivision (b), for recovery on account of a voidable preference may be maintained without allegation and proof of a preference within the definition of 11 U. S. C. A., Sec. 96, Subdivision (a)."

In *Canright v. General Finance Corporation,* 123 F. 2d 98, 100 (C. C. A. 7), the court said:

> "To be sure, the law presumes that the payment is legal. To overcome this presumption and establish the essential elements of a voidable preference, the burden of proof is on the trustee."

To the same effect are *Continental and Commercial Trust and Savings Bank v. Chicago Title and Trust Co.,* 229 U. S. 435, 443; *Walker v. Wilkinson,* 296 Fed. 850, 853 (C. C. A. 5; cert. den. 265 U. S. 596); *Dinkelspiel v. Weaver,* 116 Fed. Supp. 455, 459.

A case pursuasively in point is the much cited authority, *In re Field Heating and Ventilating Co.,* 201 F. 2d 316 (C. C. A. 7), where the court held that where the right of set-off exists questions as to whether or not the creditor had, at the time of the transfer, reasonable cause to believe that the debtor was insolvent, and similar questions were unimportant and immaterial. In that case,

Northbrook Homes, Inc., a creditor of the bankrupt, filed a claim against the debtor's estate for $3,289, a balance on an indebtedness due from the bankrupt for money borrowed in the sum of $11,000, which amount had been reduced by set-off credits to the sum of $3,289. The trustee in bankruptcy filed a counterclaim in which he averred that the credits by which the claimant reduced its demand had been obtained by means of payments made by the bankrupt under such circumstances as to amount to a preference voidable under the provisions of the Bankruptcy Act. Answering the counterclaim of the trustee, the creditor asserted that the credits did not amount to a preference but were, in legal effect, merely the accomplishment of a mutual set-off under the provisions of Section 68(a) of the Bankruptcy Act. The Referee found the creditor's claim was an avoidable preference recoverable by the trustee, and the District Court approved the conclusions of the Referee and entered judgment accordingly. The opinion of the Court of Appeals reversing the judgment is so important to the present situation that, for the convenience of the court, it is quoted at considerable length. At page 318 the court said:

> "In February, 1951, claimant owed the bankrupt for construction work done for it by the latter; the bankrupt owed claimant for borrowed money. If either had brought suit, the other might have pleaded set-off. Instead of doing so, they exchanged checks. neither took anything from the other's estate. Their trial balances of accounts payable and receivable recorded only a reduction of accounts payable in one instance and of accounts receivable in the other balancing each other. The net estate of each remained the same both before and after the checks

were exchanged. Thus the essential element of a preference, *i. e.,* something which diminishes the estate, National Bank of Newport v. National Herkimer County Bank, 225 U. S. 178, 184, 185, 32 S. Ct. 633, 56 L. Ed. 1042, is lacking. We can conceive of no more appropriate application of the doctrine of set-off than that presented here. Prudential Insurance Company v. Nelson, 101 F. 2d 441, 443.

"The trustee argues that to approve the set-off here is to permit claimant to recover more than its pro rata share of its debt as compared with other creditors. Such is always the result of true set-offs under the Bankruptcy Act. As the Supreme Court in New York County National Bank v. Massey, Trustee, 192 U. S. 138, 147, 24 S. Ct. 199, 201, 48 L. Ed. 380, said: 'It is true that it (the deposit) creates a debt, which, as the creditor may set it off under Section 68, amounts to permitting a creditor of that class to obtain more from the bankrupt's estate than creditors who are in the same situation and do not hold any debts of the bankrupt subject to set-off. But this does not, in our opinion, operate to enlarge the scope of the statute defining preference so as to prevent set-off in cases coming within the terms of Section 68(a). If this argument were to prevail, it would, in cases of insolvency, defeat the right of set-off recognized and enforced in the law, as every creditor of the bankrupt holding a claim against the estate subject to reduction to the full amount of a debt due the bankrupt receives a preference in the fact that, to the extent of the set-off, he is paid in full.' "

Then quoting from *Studley v. Boylston National Bank,* 229 U. S. 523, the court said at page 528:

"If this set-off of mutual debts has been lawfully made by the parties before the petition is filed, there

is no necessity for the trustee doing so. If it has not been done by the parties, then, under command of the statute, it must be done by the trustee."

Another case of similar import is *Addington v. Forsythe Metal Goods,* 136 N. E. 305 (N. Y., 1922), where a bankrupt made a contract for the manufacture of certain articles of merchandise, advancing payment on the contemplated future deliveries. Within four months bankruptcy intervened and the articles had not been manufactured. The bankrupt was indebted to the manufacturer on a balance due under a previous contract. The court held that this old balance could, under Section 68(a), be charged by the manufacturer and set-off or counterclaimed against the deposit. Application for certiori was denied by the Supreme Court of the United States, 263, U. S. 700.

Courts have always been intent upon achieving substantial justice through the medium of set-off and counterclaim. They have ever disregarded the fact that the practical result of allowing a set-off is to diminish payment to other creditors. This was decided as long ago as 1872. In *Drake v. Rollo, 7* Fed. Cas. No. 4066, page 1035, a case in which an insurance loss was permitted to be counterclaimed against an indebtedness to the insurance company, the court said:

"It is true in this case the plaintiff obtained part of the means which the company possessed with which to meet its liabilities in case of loss, and by permitting a set-off which enables plaintiff to receive payment in full of his claim, while general creditors are only partially paid, and thus he becomes a preferred creditor. But it is a *preference growing out of the business relations of the parties* as they stood

at the time of the fire which rendered the company insolvent." (The court had reference to the great Chicago fire of October 9, 1871.) (Emphasis supplied.)

For at least a year prior to bankruptcy, appellants, as is conceded, performed extensive services for the publishing company, requiring among other things two trips to New York, two to San Diego, one to San Francisco and one to Chicago, all, doubtless, in the effort to save and preserve the company and its newspaper, "The Daily News," for the stockholders and its creditors. No claim for such services has been or will be filed. But in connection with their efforts, appellants expended a substantial sum of money which was never paid. It was in the course of this business and professional relationship and in connection with the services performed, that the funds with which the special account was created came into their hands. If this could be regarded as a preference, it is, as in *Drake v. Rollo,* "a preference growing out of the business relations of the parties."

That the approval of the counterclaim might result in appellants obtaining "more from the bankrupt estate" than general creditors, does not "operate to enlarge the scope of the statute defining preferences."

In re Field Heating and Ventilating Co., 201 F. 2d 316, 318;

New York County National Bank v. Massey, Trustee, 192 U. S. 138, 147;

Studley v. Boylston National Bank, 229 U. S. 523, 538.

The instant situation does not come within the purview of avoidable preferences as intended by the Legis-

lature. The Supreme Court of the United States, in *Continental and Commercial Trust and Savings Bank v. Chicago Title and Trust Company,* said that the purpose of the statute is to prevent the acquiring of claims of others against the bankrupt for use by way of set-off and reduction of indebtedness to the bankrupt estate. 229 U. S. 435, 443, 447.

In that case the Supreme Court said further:

> "To constitute a preferential transfer within the meaning of the bankruptcy act there must be a parting with the bankrupt's property for the benefit of the creditor and a consequent diminution of the bankrupt's estate."

It is submitted that, under the circumstances, to hold that the transfer of the fund here in controversy, constitutes an avoidable preference, would be to strike from Section 60(a) the language, "to or for the benefit of the creditor for or on account of an antecedent debt." This would do violence to the plain language of the statute and would contravene the unmistakable legislative intent.

Conclusion.

At the time of the filing of the petition in bankruptcy herein appellants and Jack L. Rau owed the bankrupt a sum of money. The fact that the indebtedness might be said to arise out of an obligation as trustee or agent is of no real consequence. As this court said, "It could not be got at without an action at law or a bill in equity." (*Half Moon Fruit and Produce Co. v. Floyd,* 60 F. 2d 799.) The liability of appellants was to pay a liquidated sum of money. At the same time the bankrupt owed appellants a fixed amount for cash advances. Appellants' real indebtedness at that point in time was the actual

net difference between these two mutual obligations. Since there is nothing in the Bankruptcy Act, and nothing in equity and good conscience which gives to the trustee in bankruptcy a greater or a different right as creditor, or a lesser obligation as debtor, there would seem to be no sound or sensible reason why the normal balance so struck should not be confirmed and the prayer of appellants' petition granted. It is urged that the order of the District Court be reversed with directions to allow appellants to reimburse themselves from the special account in the amount of $3,217.68.

Respectfully submitted,

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JACK L. RAU,

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APPENDIX.

The following is a list of cases illustrating the liberal attitude of courts with respect to set-offs and counter-claims.

In *Abraham v. Selig,* 29 F. Supp. 52 (D. C. N. Y.), the court said that a party "may claim relief different in kind from that sought by the opposing party." That case went so far as to hold that a counter-claim against individual partners could be asserted in an action upon a partnership claim in the interest of avoiding a multitude of suits.

In *Gallahar v. Rheman Co.,* 50 F. Supp. 655, 661 (D. C. S. D. Ga.), it was said that the philosophy of Rule 13 and others of the Federal Rules is to discourage separate actions which make for a multiplicity of suits, and wherever possible to permit, and frequently require, combining in one litigation all of the claims and cross-claims of the parties.

In *Kuenzel v. Union Carloading Co.,* 29 F. Supp. 407, 409 (D. C. E. D. Pa) (heretofore cited) the court said that these rules are designed to enable the disposition of a whole controversy of interested parties' conflicting claims, at one time and in one action.

In *Brown Paper Mill Co. v. Agar Mfg. Corp.,* 1 F. R. D. 579, 580 (D. C. N. Y.) the court said that Rule 13 was enacted for the purpose of dispensing with needless independent actions when those existing causes of action might be brought as permissive counter-claims against an opponent.

In *Wyckoff v. Williams,* 121 N. Y. S. 189, the court went so far as to hold that a set-off should be allowed where injustice would otherwise result, even though an

action at law could not be maintained on the claim in question.

Other cases which decide that the parties, whenever possible, should adjust all of their difficulties in one lawsuit, are the following:

Moore's Federal Practice, Vol. 1, pp. 684, 701;

Marks v. Spitz, 4 F. R. D. 348, 350 (D. C. Mass.);

Carter Oil Co. v. Wood, 30 F. Supp. 875, 877 (D. C. E. D. Ill.);

Arizona Lead Mines v. Sullivan Mining Co., 3 F. R. D. 135, 139 (D. C. Ida.);

Lesnik v. Public Industrial Corp., 51 F. Supp. 989, 992 (D. C. N. Y.);

Seagram Distillers v. Monos, 25 F. Supp. 233, 234 (D. C. W. D. So. Car.);

Madison Mercantile Products v. Frank, 7 F. R. D. 615, 616 (D. C. N. J.);

Ohio Casualty Ins. Co. v. Maloney, 3 F. R. D. 341, 342 (D. C. E. D. Pa.).

No. 15073.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

DESSER, RAU & HOFFMAN and JACK L. RAU, individually,
Appellants,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of Stockholders Publishing Company, Inc., a bankrupt,
Appellee.

APPELLEE'S BRIEF.

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No. 15073.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

DESSER, RAU & HOFFMAN and JACK L. RAU, individually,
Appellants,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of Stockholders Publishing Company, Inc., a bankrupt,
Appellee.

APPELLEE'S BRIEF.

Statement of the Case.

The facts in this case are uncomplicated. A clear understanding of these facts will make eminently clear why there could have been no other result than that reached by both the Referee and the District Court.

An Involuntary Petition in Bankruptcy was filed against Stockholders Publishing Company, the bankrupt corporation, on December 31, 1954. Stockholders Publishing Company had been publishing the Daily News, a metropolitan daily paper in Los Angeles, and had terminated its operation approximately two weeks previously, on December 18, 1954.

Prior to the commencement of the bankruptcy proceeding, the firm of Desser, Rau and Hoffman, Appellants herein, acted as attorneys for the bankrupt corporation. Arthur Desser, one of the partners in said firm of attorneys, was an officer of the bankrupt corporation during

December, 1954, as well as many months prior thereto. At a meeting of the Board of Directors of the bankrupt corporation held on December 18, 1954, the Board authorized the termination of operation and also authorized the president of the corporation to institute bankruptcy proceedings. Arthur Desser was present and participated in such meeting.

After ceasing its operation on December 18, 1954, the bankrupt corporation determined that it needed access to a new bank account for the protection of its incoming funds and for the making of certain essential disbursements from said funds. For this specific purpose, on December 20, 1954, Appellants, Desser, Rau and Hoffman, acting as attorneys for the bankrupt corporation and on behalf of the bankrupt corporation, opened at the Union Bank & Trust Company of Los Angeles a bank account designated as "Jack L. Rau, Special Account." In such bank account there was deposited by the corporation certain funds belonging to the corporation, and out of said account certain disbursements were made on behalf of the corporation.

With reasonable promptness after the commencement of the bankruptcy proceedings, Appellants rendered an accounting of the receipts and disbursements on said Special bank account to George T. Goggin, the Receiver, at which time the account contained the sum of $16,163.15. Appellants remitted to the Receiver the sum of $12,945.47, and retained in said Special account the sum of $3,217.68. This latter sum is the fund which is the subject matter of this litigation and this appeal.

Appellants claim, and the Trustee did not dispute, that in the year preceding December 18, 1954, Appellants had expended from their own funds on behalf of the bankrupt

corporation the sum of $3,217.68 for various expenses on behalf of the bankrupt corporation.

The instant proceeding was commenced by the filing by Appellants on January 21, 1955, of a Petition praying that the Referee make an Order authorizing Appellants to pay to themselves out of said Special account said sum of $3,217.68, to reimburse Appellants for cash advances made on the bankrupt's behalf in the year prior to December 18, 1954. The Referee held that it was clear that Rau held the moneys in the Special account as trustee or agent of the bankrupt corporation and did not acquire any other interest in this fund. The Referee held that the moneys in this bank account constituted property of the bankrupt corporation.

The Referee held that, as the fund in controversy constituted property of the bankrupt, this was not a matter within the provisions of Section 68a of the Bankruptcy Act, providing for set-offs in the cases of mutual debts or mutual credits between the estate of the bankrupt and a creditor. The District Court, upon review of this matter, not only approved and affirmed the Order of the Referee, but approved and adopted the Referee's Findings of Fact and Conclusions of Law.

The facts and the law of this case are so simple that the fact that the matter has now been taken on appeal to the Court of Appeals has alarmed this conservative counsel for the Trustee into a careful re-examination of the entire proceeding. Because of the obvious industry which has been put into the matter both below and on this appeal by counsel for Appellants, it can not really be said that this appeal is frivolous; yet the absence of a direct relation between the law argued by Appellants and the facts of the case presents Appellee an unusual problem.

ARGUMENT.

Appellants present what is ostensibly a three-point legal argument to support their theory upon appeal:

1. That the subject sum of $3,217.68 is a debt owing from Appellants to the bankrupt, which debt Appellants are entitled to set off against the obligation owing to Appellants by the bankrupt, by virtue of Section 68a of the Bankruptcy Act.

2. That Rule 13 of the Federal Rules of Civil Procedure broadens the meaning of Section 68a and thereby increases the rights of a creditor asserting set-off.

3. That there was some transfer by the bankrupt to Appellants, which transfer was not a voidable preference.

I.

The Sum Retained in the "Jack L. Rau Special Account" Was a Trust Fund, Property of the Bankrupt, Which Jack L. Rau Held as Trustee for the Bankrupt (and Not as Agent for Appellants) and Therefore Appellants Have Absolutely No Right to Set Off Such Amount Against a Debt Owing by the Bankrupt to Them.

The undisputed facts disclosed that on the date of bankruptcy Jack L. Rau was the Trustee of certain funds which were the property of the bankrupt corporation. The provisions of Section 68a of the Bankruptcy Act are in no way applicable.

Appellants state as follows in their brief (p. 10):

> "It is *admitted* that at the time of the filing of the Petition in Bankruptcy Appellants *owed* the bankrupt the balance in a special fund. . . ." (Emphasis added.)

Appellants are the only ones doing such "admitting", and their use of the word "owed" underlines their continuing basic misconception of the simple situation herein presented. However, this completely unwarranted use of the term "owed" is quite essential in the effort by Appellants to establish some basis to talk about Section 68a. The principal case cited by Appellants to support this phase of their theory is this Court's decision in *Half Moon Fruit & Produce v. Floyd,* 60 F. 2d 799. This Court will recall that in the *Half Moon* case a commission merchant who had made seasonal cash advances to a grower to enable him to produce his crop was held to be entitled to an equitable lien on melons consigned to him by the grower, and entitled to a "mutual credit" in the "set-off"sense for such advances against the proceeds of the sale of the melons. Appellee does not see just how such case can be made to support a contention by a trustee of a special bank account that he is entitled, after bankruptcy, to have transferred to a partnership in which he is interested a portion of that account to satisfy an antecedent unsecured obligation owing to said partnership by the bankrupt.

The law is clear that where the liability of one claiming a set-off arises from a fiduciary duty or is in the nature of a trust, the requisite mutuality of debts or credits does not exist, and such person may not set off a debt owing from the bankrupt to such liability.

4 Collier on Bankruptcy (14th Ed.) 726.

The United States Supreme Court long ago made a definitive statement on this point in the case of *Western Tie & Timber Co. v. Brown,* 196 U. S. 502, 49 L. Ed. 571, which case has been respected and followed since.

In the *Western Tie* case, the tie company and Harrison, the bankrupt, had been engaged in removing timber from the tie company's land, etc. The bankrupt operated stores, patronized by laborers of the tie company. The tie company deducted from the payroll the amount owed by the laborers to the bankrupt for purchases. Against a $24,000.00 debt owed to it by the bankrupt the tie company attempted to set off $2,210.73 collected from payrolls and held for the bankrupt. The United States Supreme Court said that the creditor could not set this off. The creditor was in a position of a trustee and therefore the case was not one of mutual credits and debts within the meaning of the set-off clause of the Bankruptcy Act.

See, also:

Arkansas Fuel Oil Co. v. Leisk, 133 F. 2d 79, following the law of the *Western Tie* case.

A recent case in point is that of *In re Zuckerman* (D.C. N.Y. 1955), Commerce Clearing House Decisions, par. 58,303, where the Court held that a landlord may not set off a sum deposited with him as security for the performance of a lease, against a debt owing by the bankrupt for unpaid rent.

This court, in a 1956 ruling on the applicability of Section 68a, held that where a bank account is impressed with the character of a trust fund, even the creditor bank could not assert a right of set-off.

First National Bank of Portland v. Dudley, 231 F. 2d 396 (C. A. 9, Mar. 13, 1956).

In the latter case, the bank had joined other creditors of the bankrupt in a pre-bankruptcy extension arrangement, pursuant to which proceeds from liquidation of the bankrupt's inventory were to be applied toward payment of all claims on an equal basis; and the Court held that the bank account created by such proceeds was impressed with the character of a trust fund. The bank not only was refused a right of set-off, but was estopped to assert the usual banker's lien.

When the facts of the instant case are re-examined it can be seen just how inappropriate any application of Section 68a would be.

The bankrupt owed money to Appellants. The Appellants assert a "set-off" to such debt. They have, they say, a "mutual debt" owing by them to the bankrupt which they wish to so set off. Where and what is this "debt"? Perforce, it must be, somehow, in the funds held by Jack L. Rau in the "Jack L. Rau, Special Account", a trust account admittedly set up on behalf of the bankrupt corporation, with funds of the bankrupt corporation only, and solely for purposes of the bankrupt.

At what point does a debt from Appellants to the bankrupt appear? No one has ever asserted that Jack L. Rau violated his trust and transferred any part of such funds to Appellants. No one has ever asserted that Jack L. Rau silently changed his status from that of trustee for the bankrupt to that of agent of Appellants. On the contrary. Mr. Rau's conduct appears to have been quite proper, and consistent with his duties as trustee. He filed an account-

ing with the Receiver and the Bankruptcy Court and stated that he still retained in the special account the subject sum of $3,217.68. [Petition to Allow Payment of Expenses, Tr. 4.]

There obviously was no transfer of funds from the bankrupt to Appellants. (And for this reason, no preference. See *infra.*) Appellee simply cannot bridge the gap in Appellants' argument at the vague point where the fund in the trust account becomes, in the course of Appellants' discussion, a general indebtedness of Jack L. Rau (and hence of Appellants, the firm of Desser, Rau & Hoffman) to the bankrupt corporation. No transfer, merely a transformation! Possibly a chemical reaction induced by the injection of one petition in involuntary bankruptcy.

Appellants state (App. Br. p. 31) that they and Jack L. Rau, at the date of bankruptcy, "owed" the bankrupt $16,163.15. And to Appellants, whether they "owed" this sum as an ordinary debtor or as a trustee "makes no difference." This theory is the heart and the entirety of Appellants' position on this appeal, and on this theory Appellants must fail.

II.

Appellants' Discussion of the Federal Rules of Civil Procedure Is Inappropriate and Irrelevant.

No issue concerning the applicability of Rule 13 of the Federal Rules of Civil Procedure was before the Referee or the District Court.

Furthermore, Appellants have not suppported their general discussion on this point with a single case relating either to Section 68a or the case at bar.

III.

There Was No Transfer From the Bankrupt to Appellants and Therefore No Preference. If Appellants Had Received Such Fund From the Bankrupt, Such Transfer Would Have Been a Voidable Preference Under Section 60 of the Bankruptcy Act.

Appellants, both in the argument before the District Court and in their brief herein (pp. 30-40) have created quite a straw man as to the issue of "voidable preference," but even then do not succeed in knocking their man down. With all due respect to counsel for Appellants as well as to this Court, it is submitted that the discussion in Section II Appellants' brief (pp. 30-40) on the subject of bankruptcy preference as related to the facts of this case constitutes legal double-talk. There was no transfer; therefore there could be no preference.

In their original petition before the Referee [Petition to Allow Payment of Expenses, Tr. 3 *et seq.*] Appellants asserted that on January 5, 1955, the trust account "contained the sum of $16,163.15," that $12,945.47 had since been remitted to the Receiver, and that there remained in the account the subject sum of $3,217.68. They petitioned the Court for an order authorizing payment of this sum to them from said account. Appellee sees no transfer.

But permit us to run with Appellants' football for a moment. If by some means, Appellants had received funds of the bankrupt corporation corporation via moneys placed into the Special Account, what would be the effect of Section 60a of the Bankruptcy Act? The transfer would be on December 20, 1954, or later. The bankrupt was indebted to Appellants on an antecedent obligation in the sum of $3,217.68. This antecedent obligation was

totally unsecured. On December 18, 1954, two days prior to the opening of the Special Account, Arthur Desser, a member of Appellants, acting as an officer and director of the bankrupt corporation, participated in the meeting of the Board of Directors of the insolvent corporation at which meeting the Board authorized the termination of business operation and the filing of bankruptcy on behalf of the bankrupt corporation. The actual bankruptcy proceedings were commenced December 31, 1954. If there had been a transfer to Appellants, how could there be a more clear-cut example of a voidable preference within the meaning of Section 60a of the Bankruutcy Act?

As emphasized by the United States Supreme Court in the *Western Tie* case, *supra,* where the creditor had claimed a right to set-off, if the money had been applied to the debt "the necessary result of the transaction would have been to create a voidable preference."

> *Western Tie & Timber Co. v. Brown,* 196 U. S. 502, 508, 49 L. Ed. 571, 574.

However, as both Appellants and Appellee agree that there was no transfer of funds by the bankrupt to Appellants, the all-important question is: Just what is it that Appellants have which they claim a right to keep on the basis of an alleged right of "set-off"?

Conclusion.

The $3,217.68 held in the Jack L. Rau Special Account constituted property of the bankrupt corporation which Jack L. Rau held as Trustee of the bankrupt corporation. There is no mutuality of debts or credits between said trust fund held by Jack L. Rau and the obligation of the bankrupt corporation to Appellants.

The Referee committed no error.

The District Court committed no error in affirming the order of the Referee and approving and adopting the Referee's Findings of Fact and Conclusions of Law.

Appellee submits that the Order of the District Court should be affirmed.

Respectfully submitted,

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DESSER, RAU & HOFFMAN and JACK L. RAU, Individually,

Appellants,

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GEORGE T. GOGGIN, Trustee in Bankruptcy of Stockholders Publishing Company, Inc., a bankrupt,

Appellee.

Appeal From the United States District Court for the Southern District of California, Central Division.

REPLY BRIEF FOR APPELLANTS.

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REPLY BRIEF FOR APPELLANTS.

Introduction.

It is unfortunate that the self-styled "conservative counsel for the Trustee" are so restrictive in their thinking by confinement to the usual and stereotyped situations in bankruptcy that they cannot look beyond the barriers of their experience to see the gradual approach by the courts to a liberal and sensible treatment of claims and counterclaims, to reach an equitable conclusion in such situations.

Absent bankruptcy, there would seem to be nothing in the law which prevents a party indebted to another in a trust capacity from setting off, in his final accounting, an indebtedness of the *cestui* to him. Assuming that a Trustee did so account in full, he could, of course, immediately thereafter, or simultaneously, sue and obtain a judgment against the *cestui* for the amount due. The doctrine of set-off cuts across this needless proceeding. What is there in the law of bankruptcy which prevents the same result as between a so-called fiduciary creditor and a trustee in bankruptcy? In considering this aspect of the appeal, the question of mutuality of the respective claims should be, as counsel for appellee concede [T. Br. 8],[1] divorced from any question of voidable preference. The naked issue is, do the claim of the Trustee for the amount of the special account and the claim of appellants for cash advances constitute mutual debts or credits. Appellee contends that they do not because the claim of the Trustee is based upon the fiduciary's liability and the claim of appellants is a "straight" claim for money due and owing. The Trustee's preoccupation with the idea that his claim is not a "general" claim or indebtedness and is therefore removed from the scope of the doctrine of set-off in bankruptcy, is responsible for the basic error in appellee's position.

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[1]When appellants' opening brief is hereafter referred to, it will usually be indicated by the bracketed abbreviation [O. Br. ....], and when the brief for the trustee-appellee is referred to, it will be indicated as [T. Br. ....].

It is this misconception which appellants attempted to dissipate in their opening brief [O. Br. 15-29], wherein cases were cited which recognize the "broad significance to be given to the phrase 'mutual credits' and demonstrate that actual or equitable ownership by a bankrupt of the funds or property held by a creditor against which the creditor asserts his counter demand, does not preclude the operation of set-off."

Except as to *Half Moon Fruit and Produce Co. v. Floyd,* 60 F. 2d 799, as to which an erroneous discussion is presented by appellee, no attempt is made to distinguish appellants' authorities and no contention presented to show their inapplicability to appellants' position.

The same is true as to appellants' contentions as to avoidable preferences which appellee terms a straw man argument. As this Court has doubtless already perceived, the straw man was a creature of the Referee who wanted it to be understood that if he was wrong in his conclusions as to the mutuality of the respective claims, the preference theory was a convenient refuge.

ARGUMENT.

I.

Appellee's Point I to the Effect That Because the Jack L. Rau Special Account Was Held by Rau as Trustee for the Bankrupt and That, Therefore, Appellants Have No Right to Set Off a Debt Due From the Bankrupt to Them Is Not Sound and Is Not Supported by the Authorites Relied Upon.

The principal thesis of appellants' opening brief is that the equitable ownership of the fund in the Rau special account or capacity in which it was held in the name of Rau, is not determinative against the right of set-off and does not mean that the respective claims were not mutual within the meaning of Section 68(a) of the Bankruptcy Act. Supporting that proposition, appellants cited cases which recognize the "broad significance" given to the phrase "mutual credits" and holding that "the yardstick for the determination of the right of set-off in bankruptcy is whether each owes the other, and if such reciprocal demand exists, one may be set off against the other no matter whether insolvency is present * * *"; and holding, further, that it is not necessary to justify set-off that the claims be of the same character; "claims of different species may be set off if they are mutual," *i.e.,* if each owes the other. There is no satisfactory answer to this position in appellee's brief.

The Trustee takes issue with the use of the word "owe" or "owed," evidently believing that a fund held in a trust capacity, when the activity of the trust is ended, is not "owed" to the equitable owner.

The dictionary definition of the word "owe" is, "to be under an obligation, to render (something) in return for something received; to be indebted in the sum of; to have an obligation to (someone) on acount of something done or received; to be indebted." That the word "owe" merely implies an indebtedness and that there may be an indebtedness "owing" by a trustee to his *cestui* appears in one place, as will be seen, even if the authorities of appellee [*post,* 8].

Appellee attempts, furthermore, to gain support for his position on the ground that the special account was held by Jack L. Rau as Trustee for the bankrupt, not as agent for appellants and that, therefore, appellants have no right of set-off "of such amount" against a debt owing by the bankrupt to them. In his statement of facts, however, the Trustee concedes that appellants, "acting as attorneys for the bankrupt corporation and on behalf of the bankrupt corporation, opened at the Union Bank and Trust Company of Los Angeles a bank account designated as 'Jack L. Rau, Special Account.'" [T. Br. 2.] The Referee made a finding that it was the appellants' law firm, acting as attorneys for the bankrupt corporation, who opened the special account. [Finding III, Tr. 10-11.] Certainly the appellant firm, Desser, Rau & Hoffman, to whom the funds were delivered, and who created the special account, were liable to account for and pay the balance remaining at the time of bankruptcy. Indeed, the order appealed from orders Desser, Rau & Hoffman, as well as, Jack L. Rau, individually, to pay to the Trustee the sum requested to be deducted as a set-off. [Tr. 20.] Hence there is no point in attempting to limit this review

by the technical name or designation of the account as the "Jack L. Rau, Special Account."

To get down to the substance of the argument, it is believed that the best aid appellants can render to this Court is to analyze the authorities discussed and used by appellee.

In attempting to distinguish *Half Moon Fruit and Produce Co. v. Floyd,* 60 F. 2d 799, appellee asserts that in that case the commission merchant was held by this Court to have the right of set-off of the amount of advances previously made to the bankrupt against the proceeds of the sale of melons consigned to the merchant by the bankrupt and owned by the bankrupt. This right of set-off, appellee indicates to this Court, was predicated upon the fact that the merchant was entitled to an equitable lien on the melons consigned to him by the grower and entitled to a "mutual credit" in the set-off sense for the previous advances. Appellee omits the extremely important fact that *the merchant had forfeited this lien* by making an affidavit for attachment, stating he had no lien. This Court held that such a forfeiture or waiver of lien did not render the transfer of the produce to the merchant unlawful where no avoidable preference was created at the time of the transfer. In the *Half Moon* case this Court discussed two propositions: (1) The court held that the transfer of the bankrupt's property occurred at the time of the delivery of the melons to the merchant, not upon the receipt of the proceeds of sale; that while the lien of the merchant was lost or waived by the attachment, that fact did not change the date of the transfer and render an otherwise lawful transaction

unlawful by treating the transfer as occurring at the time of the receipt of the proceeds of sale within four months before bankruptcy occurred; (2) But as a distinct and self-sufficient ground for sustaining the merchant's position, the Court treated the proceeds of the sale of the bankrupt's melons, on which the merchant had no lien, and the indebtedness for prior advances, as a situation involving mutual debts or credits. At page 802 of the opinion, the Court cites with approval, *Murray v. Riggs,* 15 Johns. (N. Y.) 571, 592, where the court said, "that mutual credit was not confined to pecuniary demands, but extended to all cases where the creditor had goods in his hands of the debtor which could not be got at without an action at law, or a bill in equity." As has been said, as between the instant bankrupt and appellants, the money on deposit could not be "got at" without some legal proceeding. In the *Half Moon* case, the referee's order denying the right of set-off, which was approved by the trial court, was reversed with instructions to allow the merchant's claim in full, less credits for 75 cars of melons, "that is to say, $51,101.53," a substantial sum to remove from the bankrupt estate.

Appellee refers to 4 *Collier on Bankruptcy* [14th Ed.] 726 in support of the assertion that where the liability of one claiming set-off, "arises from a fiduciary duty or is in the nature of a trust, the requisite mutuality of debts or credits does not exist, and such person may not set off a debt owing from the bankrupt to such liability." [T. Br. 5.] In the voluminous footnotes "supporting" the broad generality of the text, are revealing decisions. It is to be particularly noted that the "fiduciary duty" mentioned in these decisions *was violated* by the claimant

seeking to set off or counterclaim. Thus, in *Putnam v. Handy,* 251 Mass. 196, there was a breach of fiduciary duty by a corporate officer; and in *Walker v. Man,* 253 N. Y. Supp. 472, there was a breach of duty by a corporate director; and in *Lytle v. Andrews* [C. C. A. 8], 34 F. 2d 252, money was fraudulently received by a controlling stockholder.

Collier quotes, in the footnotes also, what seems to be the explanatory or reconciling case of *Morris v. Winsor Trust Co.,* 213 N. Y. 27, 106 N. E. 753. There a wrongdoer who had misapplied the subject of the trust was held not to be entitled, either under the Bankruptcy Act or under the rules of equitable set-off, to apply a credit that belonged to him in his own right in cancelling his liability as a fiduciary.

Collier goes on to say in the footnotes at page 727 [Footnote 29]:

> ". . . and where a claimant against a bankrupt's estate is also indebted to the estate upon a debt arising from his possession of property belonging to the bankrupt, his duty to account to the bankruptcy trustee cannot be set off against the bankrupt's debt to him *if his possession was wrongful,* but *if his possession was obtained with the bankrupt's consent, the debts are mutual and subject to set-off.*" [Emphasis supplied.]

Citing *Bristol v. Killanna Corp.* [C. C. A. 2], 85 F. 2d 667. It should be noted, parenthetically, that the language speaks of a claimant *"indebted to the estate upon a debt arising from his possession of property belonging to the bankrupt,"* a statement distinctly at variance with appellee's contention that the use of the word "owed" by

appellants, in speaking of a trustee's obligation, is unwarranted and creates a basic misconception.

Among other decisions, Collier, in the footnotes, cites the case of *Levy v. Drew,* 4 Cal. 2d 456, which is one of the cases which makes the right to assert a set-off dependent upon whether or not the creditor's possession of the bankrupt's funds or property was obtained properly or improperly. In *Levy v. Drew,* the court, in quoting from and adopting its own prior opinion in the same case, said at page 460:

> "The rule is consistently applied in the federal court that when a debtor, prior to bankruptcy, voluntarily places in the hands of his creditor assets for the particular purpose of extinguishing a debt, and bankruptcy occurs, the creditor can offset his demand against the claim of the trustee in bankruptcy for a return of the assets to the bankrupt estate."

The court then goes on to say:

> "It is equally well settled that the unauthorized possession of funds of the bankrupt can give the creditor no right to apply them to the payment of his own claim to the prejudice of the rights of other creditors. [Citing federal cases.]
>
> "In the instant case, the money was not voluntarily paid to defendant by the corporation, but was forcibly seized by the levy of an execution, nor was it voluntarily handed over to be applied on the particular debt owed to defendant. When his judgment was vacated defendant's possession of the money became illegal and he should have restored it to his debtor."

In the footnotes, at page 727 of 4 Collier on Bankruptcy, appears, in boldface type, "Exception as to attorney at law holding funds of bankrupt." The author

cites *In the Matter of Redmond and Co.* [D. C. Mass.], 17 F. 2d 501, where the court took note of, but distinguished, among other cases, *Western Tie & Timber Co. v. Brown,* 196 U. S. 502. In the *Redmond* case, an attorney, acting for a client, invested money for the client who had been in control of the bankrupt corporation, in certain corporate stock, receiving the dividends which the attorney, Ginsberg, kept in a separate account. He was held to be entitled, under Section 68(a) of the Bankruptcy Act, to set-off his claim for fees as general counsel for the bankrupt corporation against the claim of the trustees in bankruptcy who had been adjudged to be entitled to the stock and dividends as against Ginsberg's client, who had been so in control of the bankrupt corporation. The court said:

> "But I do not go with the trustees to the extent of agreetng that Ginsberg had no right to set-off his claim for services against the trustee's claim to dividends in his hands. The contention of the trustees relative to the right of set-off is based on a well settled doctrine that a simple debt cannot be set off against a quasi-fiduciary obligation such as Ginsberg owed the bankrupt corporation. [Citing the *Western Tie Co.* case and other authorities.]
>
> "These cases and others cited by the trustees, however, deal with the rights of creditors other than an attorney at law. That an attorney at law has a right to set off his claim for compensation against funds in his hands which belong to his client, has long been recognized in the courts of this state. [Citing cases.]
>
> "The Supreme Court of the United States, in considering the right of set-off under Section 68(a), has pointed out that the object of the provisions of

the section was to permit the statement of account between the bankrupt and the creditor with the view of the application of the doctrine of set-off between mutual debts and credits . . .

"I am inclined to the opinion, in view of *Blake v. Corcoran, supra,* which this court may well adopt as stating the applicable law, that the right of set-off which Ginsberg asserts in these proceedings is one which comes within the established principles of set-off and was properly recognized by the Referee.

"I attach no controlling importance that the dividends were kept in a separate account. His obligation to the corporation would have been the same whether he kept the funds separate or mingled them with his own. In every case where an attorney has money in his hands belonging to his client, he assumes a quasi-fiduciary relationship with reference to the funds."

Appellants strongly rely upon *Western Tie & Timber Co. v. Brown,* 196 U. S. 502. [T. Br. 5.] In that case there had been a long course of dealing between the tie company and Harrison, the bankrupt, in which the tie company's employees bought goods from Harrison, who habitually made a record of such purchases and forwarded it to the tie company which would deduct the amounts of the various employees' indebtednesses to Harrison from pay due to them, and would remit such sums to Harrison in full regardless of how much Harrison might be indebted to the tie company at the time of these remittances. The deductions represented, not amounts owing to Harrison by the tie company, but by the latter's employees individually. Thus, when the tie company determined to hold and keep amounts deducted from payroll, and credit

such amounts to the indebtednes of Harrison to the tie company, *it was attempting to extinguish the liability of other persons* to the bankrupt, and allow, as a credit, the amount thereof against the bankrupt's indebtedness to it. At page 507 of the opinion, the court said:

> "We think the findings establish that Harrison sold the goods, not to the tie company, but to the laborers, and, therefore, the result of the sale was to create an indebtedness for the price alone between Harrison and the employees.
>
> "We think, also, that the facts found establish that the course of dealing between Harrison and the tie company concerning the deductions from the payrolls was that the tie company, when it made the deductions, was under an obligation to remit the money collected from the laborers for account of Harrison, irrespective of any debt which he might owe the company."

It was because of this violation of this established course of business that the court held that the tie company was not entitled to retain the proceeds of the collections from its employees, which were distinct and separate from the account between the tie company and Harrison.

The case of *Arkansas Fuel & Oil Co. v. Leisk,* 133 F. 2d 79 [T. Br. 6], falls into the category of cases which hold that no right of set-off exists if the possession was wrongful. In this case, as the court observed, the appellant Arkansas Fuel & Oil Co. "admits that it *wrongfully* converted 8000 barrels of oil belonging to the bankrupt corporation . . ." (Emphasis supplied.)

The true import of the decision of this Court in *First National Bank of Portland v. Dudley,* 231 F. 2d 396, is

not disclosed by appellee's brief. The crux of that case is found in the fundamental principle of equitable estoppel and the waiver of the bank's ordinary right of set-off, which waiver was implicit in the special creditor-debtor arrangement under which it was sought to save the troubled business of the debtor. During November, 1952, the bankrupt, unable to meet its obligations in regular course, advised the bank of its condition and stated that it had a stock of merchandise which could be sold to advantage over a period of time in liquidation of indebtednesses to creditors. The debtor proposed that if the creditors, including the bank, would refrain from seeking immediate payment in full, the debtor would proceed to liquidate its inventory over a period of 12 months and would pay the bank and other creditors in full by making quarterly payments of 25% commencing January 15, 1953. The bank proposed a modification to the effect that 10% a month should be paid to the creditors. This modification was agreed to by the debtor, and the other creditors were advised of the plan, of the approval thereof by the bank and of the participation of the bank therein. The creditors agreed. The debtor then proceeded to liquidate its inventory and make 10% monthly payments to each creditor for five months. The bank received and accepted the monthly payments with accrued interest on its note originally in the sum of $22,000.00 which was thereby reduced to $11,000.00. All of the proceeds of sale were deposited in the bank.

The court found that:

> "By its approval of the bankrupt's plan, and by participation therein, the bank so dealt with its depositor, the bankrupt, and other creditors, as to waive or be estopped or assert the right of set-off."

Upon fundamental principles of equity jurisprudence, the court held that common honesty, ordinary fairness and good conscience required the application of the doctrine of equitable estoppel. By thus inducing other creditors to go along, and themselves abandon any immediate right of action and remedy they might have had, a distinctly special situation was presented as to which the court wisely went back to first principles, making inapplicable the italicized comment of appellee preceding his inadequate discussion of this decision. [T. Br. 6.]

When, in conclusion of the argument under their Point I counsel for appellee exclaims, "No transfer, merely a transformation! Possibly a chemical reaction induced by the injection of one petition in involuntary bankruptcy," they depart from their "conservatism" and attempt to indulge in a little ill-timed and inept sarcasm which adds nothing to the truly grave issues before this Court.

II.

Appellee's Point II Stating That Appellants' Discussion of the Federal Rules of Civil Procedure Is Inappropriate and Irrelevant, Is Unsupported by Any Pretense of Reasoned Argument.

In Appellants' opening brief it was pointed out that under General Order No. 37, the Federal Rules of Civil Procedure, when not inconsistent with the Bankruptcy Act or other General Orders in Bankruptcy, should be followed in bankruptcy proceedings. [Op. Br. 25.] Appellants show that the "legislative" history of Rule 13 applicable to set-offs, and the decisions thereunder, demonstrated the intended and judicially approved liberal scope of the Rule as covering all manner of counter demands no matter how

different in their legal nature. On the face of it, this directly refutes the "conservative" contention that the fiduciary character of the Trustee's claim against appellants prevents the operation of the doctrine of set-off as against appellants' simple claim at law for a definite amount, concedely owing.

When appellee states that no issue concerning the applicability of Rule 13 was before the Referee or the District Court, he forgets that the identical contention was made below both before the Referee and before the Court, as is shown by the briefs filed below which appellee insisted be made a part of this record and which are on file here for this Court's examination.

It is asserted [T. Br. 8] that no case was cited by appellants relating to Section 68(a) or the case at bar. Neither, it may be observed, did appellants cite a case involving a bankrupt newspaper. As has been said, the six-line conclusion of appellee as to this aspect of the appeal does not impair the relevance of appellants' opening discussion of the effect of Rule 13. [O. Br. 25.]

III.

Appellee's Point III to the Effect That There Was No Transfer From the Bankrupt to Appellants and That, if There Had Been, It Would Constitute Avoidable Preference, Is Untenable.

Under this point appellee contends that there was no transfer of funds from the bankrupt to appellants and that, therefore, there can be no preference. If this be so, how did it happen that the funds deposited in the special account by the appellant firm were found in the possession and control of appellants in the Jack L. Rau special ac-

count at the time bankruptcy occurred? Such a statement, of course, is wholly unrealistic because possession and the right and power of disbursement rested in appellants. Jack L. Rau, appellants' designated partner, was required to and did sign the checks drawn on the account which accomplished the transfer to the payees thereof of a corresponding legal claim to the funds on deposit. The transfer to the receiver of the amount on deposit, less the sum claimed by appellants was accomplished, indeed had to be accomplished, by a legal document—a check drawn by Rau on the account. Compliance with the order appealed from would require a "transfer" of funds by a similar check. To say, under such circumstances, that there was no transfer by the bankrupt to appellants is to ignore the facts.

What appellee doubtless means is that there was no transfer of full ownership in the funds by the bankrupt to appellants. But appellants have shown that actual ownership of property of a debtor in possession of a creditor does not operate to defeat the assertion of a set-off or counterclaim.

Appellee, assuming, arguendo, that there was a transfer, contends [T. Br. 7-10] that the mere proximity of the date of the transfer of the funds and the commencement of the proceedings in bankruptcy results in an avoidable preference. Appellee, however, does not indicate why the language of Section 60(a) of the Bankruptcy Act, defining preference as a transfer of property of the debtor to or for the benefit of a creditor for or on account of an antecedent date (neither of which elements is here present), does not control. The "necessary result" of a transaction as creating an avoidable preference, sometimes

loosely expressed by the courts, has reference to the presence of particular circumstances constituting the full equivalent of an actual transfer to or for the benefit of a creditor, for or on account of an antecedent date. If the Congress intended so to broaden the definition, language was available for that purpose. As was shown in appellants' opening brief, the essential element of a preference "is something which diminishes the estate." [*National Bank of Newport v. National Herkimer County Bank,* 225 U. S. 178, 184; O.Br. 37.] In the instant case, the "estate" was not diminished, because, at the time of bankruptcy, the bankrupt had, in its asset column, the demand against appellants for the existing balance of the special account in the total sum of $16,163.15, and at the same time, in its liability column, was a debt of $3,217.68 owing to appellants. The net balance, or net asset represented by these concomitant items was $12,945.17, which was remitted to the receiver. The deduction of the sum of $3,217.68, while diminishing the assets in possession, also diminished the total of liabilities in exactly that amount. The net estate remained the same.

As the court said in *New York County National Bank v. Massey, trustee,* 192 U. S. 138:

> "It is true that it (the deposit) creates a debt, which, as the creditor may set it off under Section 68, amounts to permitting a creditor of that class to obtain more from the bankrupt's estate than creditors who are in the same situation and do not hold any debts of the bankrupt subject to set-off. But this does not, in our opinion, operate to enlarge the scope of the statute defining preference so as to prevent set-off in cases coming within the terms of Section 68(a). If this argument were to prevail, it would, in cases of

> insolvency, defeat the right of set-off recognized and enforced in the law, as every creditor of the bankrupt holding a claim against the estate subject to reduction to the full amount of a debt due the bankrupt receives a preference in the fact that, to the extent of the set-off, he is paid in full." [O. Br. 37.]

Appellee concludes his argument by stating that both appellants and appellee agree that there was no transfer of funds by the bankrupt to appellants. There is not and never has been any such agreement. Mistakenly, appellee regards the use of the word "transfer" as implying the conveyance of title. In their opening brief, appellants cited, among other authorities, cases involving the transfer, or delivery, of melons, the proceeds of the sale of which were to be forwarded to the grower who owned both the produce and the proceeds of sale [O. Br. 11]; the transfer of cloth to be made into clothes which, when made, were to be delivered to the bankrupt [O. Br. 20]; the transfer of parcels to a delivery service for delivery and collection, both parcels and produce belonging to the bankrupt. [O. Br. 20.] In each case set-off was allowed. In the instant case the bankrupt, prior to bankruptcy, transferred funds to appellants who selected Rau as their medium of holding, transferring and distributing same by checks signed by Rau. Here there was a transfer not only of the physical funds but also the power of disposition. The debts to be paid to creditors out of the special account could not have been paid without an actual transfer of funds to appellants.

Conclusion.

It is again urged that the order of the District Court be reversed with directors to allow appellants to reimburse themselves from the special account the sum of $3,217.68, the amount concededly due for actual out-of-pocket expenses.

Respectfully submitted,

DESSER & HOFFMAN,

DAVID R. NISALL,

JACK L. RAU,

Attorneys for Appellants.

No. 15073

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

DESSER, RAU & HOFFMAN and JACK L. RAU, Individually,

Appellants,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of Stockholders Publishing Company, Inc., a bankrupt,

Appellee.

Appeal From the United States District Court for the Southern District of California, Central Division.

PETITION FOR REHEARING.

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Appellee.

Appeal From the United States District Court for the Southern District of California, Central Division.

PETITION FOR REHEARING.

To the Honorable Judges Orr, Lemmon and Chambers, Judges of United States Court of Appeals for the Ninth Circuit:

Appellants, Desser, Rau & Hoffman and Jack L. Rau, individually, respectfully present this, their Petition for Rehearing, in the above entitled appeal, and in support of said petition hereby state the following grounds.

This Court held that to claim the right of set-off, the claimant must possess some beneficial interest in the fund or property against which the set-off is asserted. In so holding, it is believed the Court was in error.

Under the decisions, the only interest required is the right to set off or counterclaim itself, on the basis that each party owes or is indebted or otherwise obligated to, the other. This is what is meant by the words "mutual debts or mutual credits" as used in Section 68(a) of the Bankruptcy Act, according to all of the decisions. There seems to be no case requiring the presence of a particular and definable interest, beneficial or otherwise, in the fund or property against which the set-off is claimed.

Had bankruptcy not intervened and the purposes of the trust been completed, leaving a balance, the claim of the depositor of the fund for its return, certainly could be reduced by taking into consideration, in the accounting by the holder of the fund, the amount due to such holder from the depositor. Bankruptcy does not change the fundamental right to arrive at the true balance actually existing. And there is not a case which so holds. There would seem to be no justification either in the language of Section 68(a) or in precedent for the following language of the Court (pp. 3 to 4 of the opinion), "But we do think that where it (set-off) is allowed against property in the creditor's hands, the creditor must already have some beneficial interest of his own in or against the subject property, at least an equitable lien." It was to explain the position of the courts in the ordinary case of set-off and counterclaim that the Rules of Civil Procedure were discussed. These Rules do not, nor does any decision thereunder, require that the set-off claimant possess some interest of his own in the subject matter. It is believed that bankruptcy provides no exception to fundamental doctrines of set-off and counterclaim.

The reasoning of the Court that some independent and specific lien or right of the counterclaimant must exist, does not meet appellants' position. The very words of Section 68(a) in referring to mutual debts or credits, eliminates such a result. Indeed, the requirement of a beneficial interest in the party claiming set-off does violence to fundamental rules appertaining to the right of set-off or counterclaim. Each claim is separate and stands upon its own foundation.

The case of *Western Tie and Timber Co. v. Brown,* 196 U. S. 502, contrary to this Court's evaluation of that decision, is not predicated upon the circumstance that a fiduciary relationship existed, or upon the fact that a beneficial interest was or was not present in the set-off claimant, but, rather, upon a long established course of dealing which determined what was, in effect, a particular contractual relationship. The Court's attention is respectfully called to the language from the Opinion quoted at page 12 of appellants' reply brief, where the Supreme Court said that it thought that the findings established that Harrison, the bankrupt, sold goods, not to the Tie company, but to the laborers, and that, therefore, the result was to create an indebtedness for the price thereof, between Harrison and the employees alone. The Supreme Court went on to say,

> "We think, also, that the facts found establish *that the course of dealing* between Harrison and the tie company concerning the deductions from the payrolls was *that the Tie company, when it made the deductions, was under an obligation to remit the money collected from the laborers for account of Harrison, irrespective of any debt which he might owe the company.*" (Italics supplied.)

It is believed, furthermore, that the Court did not give adequate consideration to such cases as *In re Field Heating and Ventilating Co.,* 201 F. 2d 316, where the Court said that,

> "The yardstick for the determination of the right of set-off in bankruptcy is whether the debts are mutual, that is, whether each owes the other, and if such reciprocal demand exists, one may be set off against the other, no matter whether insolvency is present or whether set-off is made before or after bankruptcy intervenes, . . ." (Appellants' Original Brief, p. 21.)

The Court is respectfully requested to reconsider the other authorities discussed in this connection in appellants' opening brief at pages 19 to 23, inclusive.

The position of the Court that there is no attorney's lien under the law of California and that this distinguishes the instant case from the decision of this Court in *Half Moon Fruit and Produce Co. v. Floyd,* 60 F. 2d 799, is, it is respectfully submitted, incorrect.

In the first place, appellants are not claiming for services rendered or, indeed, for out-of-pocket expenses for the particular reason that the amount claimed was advanced as the bankrupt's attorneys. They are not claiming on the basis of any kind of lien. They simply expended their own funds, which, under any circumstances, constituted a debt of the bankrupt no matter in what capacity the amount was advanced. Had the bankrupt possessed a balance in its commercial bank account and had borrowed from the bank the amount necessary to finance the expense of its attorneys, certainly the bank, on the closing of the account, could set off, in its accounting,

the amount owed, without possessing a specific beneficial interest in the fund.

In the *Half Moon* case, the commission merchant *was held to have lost his lien.* This Court, in discussing Section 68(a) of the Bankruptcy Act, said that it was a provision borrowed from the English Bankruptcy Act which asserts,

> "a broader right of set-off than is usual because of the broad significance given to the phrase 'mutual credits.'"

Quoting from *Murray v. Riggs,* 15 Johns. (N. Y.), this Court, in the *Half Moon* case said that in dealing with the question of set-off in bankruptcy cases,

> ". . . mutual credit was not confined to pecuniary demands, but extended to all cases where the creditor had goods in his hands of the debtor and which could not be got at without an action at law or bill in equity."

This Court was not concerned, fundamentally, with the presence of an independent lien or right possessed by the counterclaiming commission merchant. (Please see Original Brief of Appellants, p. 19.)

To require as a condition precedent to the right to assert a set-off or counterclaim that the claimant must possess "some beneficial interest of his own in or against the subject property" would be to add an element to Section 68(a) of the Bankruptcy Act not contemplated by the provision itself, and not justified by judicial interpolation, at least so far as existing precedent is concerned.

It is to be noted that the specific purpose of the trust had ended. No further payments out of this special ac-

count were required or could be made on behalf of the bankrupt. The trustee's dutys, to use the fund in payment of the bankrupt's obligations were terminated by bankruptcy. All that remained was to return the existing balance to the general assets of the bankrupt. Please see, in this connection, appellants' original brief at page 24.

Conclusion.

It is earnestly urged that there is nothing in the specific language of Section 68(a), nothing in legislative policy, and nothing in the decisions which prevents a scrupulous and faithful trustee from asserting the right of set-off for a collateral debt. According to the decisions cited by Collier on Bankruptcy, and the conclusion drawn therefrom by the author, if the possession of funds or property belonging to the bankrupt was wrongful, a claim against the bankrupt cannot be set off against the bankrupt's debt, but if such possession was obtained lawfully, and with the bankrupt's consent, the claims are, mutual and subject to set-off. Please refer to appellants' reply brief, pages 7 to 11, inclusive, particularly to page 8.

It is, therefore, respectfully prayed that a rehearing be granted.

Desser & Hoffman,
David R. Nisall,
Jack L. Rau,
By David R. Nisall,
Attorneys for Appellants.

Certificate.

I, DAVID R. NISALL, one of counsel for the appellants, in the above entitled appeal, hereby certify that in my judgment, and in the judgment of all other counsel for appellants, the petition for rehearing is well founded and that it is not interposed for purposes of delay.

DAVID R. NISALL,

No. 15074

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

R. W. AGNEW,

Appellant,

vs.

CITY OF COMPTON, *et al.,*

Appellees.

Appeal From the United States District Court for the Southern District of California, Central Division.

REPLY BRIEF OF APPELLEE H. R. LINDEMULDER.

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Appellees.

Appeal From the United States District Court for the Southern District of California, Central Division.

REPLY BRIEF OF APPELLEE H. R. LINDEMULDER.

Statement of the Case.

Appellant takes this appeal from a judgment in favor of the appellee granting a motion to dismiss the appellant's complaint.

The complaint is extremely verbose and prolix. Stipped of its utterly immaterial allegations, the complaint in so far as it relates to appellee Lindemulder, alleges that the appellant was a citizen of the United States and was a licensed electrical general contractor [Tr. p. 7]; that the City of Compton was a municipal corporation and the appellee H. R. Lindemulder was a police officer of the City of Compton.

Appellant then alleges a conspiracy on the part of the various defendants to deprive him of various Federal rights. The factual material forming the predicate for this alleged violation of the appellant's Federal rights is to be found in paragraphs XI, XII and XIII of the com-

plaint [Tr. pp. 12, 13, 14]. From these allegations it clearly appears that plaintiff was apparently the owner of certain personal property worth in the neighborhood of $12,000.00; that he desired to advertise and sell this property at public auction; that the appellee Lindemulder came upon the premises of the appellant during the course of the auction conducted by the appellant and arrested him for a violation of Section 6100.7 of the Compton Municipal Code, which section of the code, according to the complaint, prohibits the engagement in the business of auctioneering without a Compton business license. Appellant was also charged with a violation of Section 6200.24 of the Compton Municipal Code, to wit, the engaging in electrical contracting business without a Compton business license.

Thereafter apparently the criminal charges against the appellant were dismissed in the Municipal Court. The basis for the dismissal is not set forth [Tr. p. 15].

It is interesting to note that the appellant does not set forth the ordinance relating to the violation of law allegedly arising out of the carrying on of the auction, although the ordinance with respect of the electrical contracting business is set forth in great detail [Tr. pp. 17, 18].

No contention is made by the appellant that he was not in fact engaged in conducting an auction. No contention is made by the appellant that he had obtained a license to engage in the business of electrical contracting as is required by Ordinance 941, as set forth in the transcript [pp. 17, 18]. No claim is asserted by appellant that he possessed a license or permit to conduct an auction as required by the ordinance. No claim of diversity of citizenship is made.

ARGUMENT.

POINT ONE.

Ordinance No. 6100.7 of the Compton Municipal Code Must in the Absence of Further Allegations, Be Presumed to Be a Valid Exercise of the Police Power of the Municipality.

It is conceded by appellant that at the time of his arrest he was engaged in the auctioning off of some $12,000.00 worth of personal property. It is submitted that the right to sell property at public auction is not one which is guaranteed by the Federal Constitution. An auction is peculiarly susceptible to police regulation. The validity of ordinances and statutes regulating auctions has been uniformly sustained throughout the country. Thus the California Court in the case of *In re Bruce,* 54 Cal. App. 280, sustained the validity of an ordinance regulating the selling of the goods at public auction. The court, after pointing out that the ordinance was obviously partly regulatory and partly for the purpose of revenue (p. 281):

> "The police power, the power to make laws to secure the comfort, convenience, peace and health of the community, is an extensive one and in its exercise a very wide discretion as to what is needful or proper for the purpose is necessarily committed to the legislative body in which the power to make such laws is vested. * * * And the purposes of a taxing ordinance may be of a mixed nature and include both regulatory provisions and those designed to produce a revenue. * * * Conceding that an ordinance of the kind here presented, of mixed purpose and intent, is to be measured according to constitutional limitations affecting revenue measures, nevertheless every reasonable presumption will be

indulged in as to its regularity, and if its terms, in any condition of the subject dealt with, appear valid, it will be sustained."

The validity of a Beverly Hills ordinance relating to auction sales, was sustained by the Supreme Court of the State of California in *Hart v. City of Beverly Hills,* 11 Cal. 2d 343, where the court thoroughly reviewed the contention that the ordinance was unconstitutional in that it violated various provisions of the State and Federal Constitutions and deprived the appellants of their property without due process of law. The court points out that auctions in their very nature are unusual in character and peculiarly call for the application of the police power to prevent disorder, breaches of the peace and fraud and otherwise preserve order and public health and safety. As the court states at page 349:

> "The police power of the state is not limited to the regulations necessary for the preservation of good order or the public health or safety. The prevention of fraud and deceit cheating and imposition is equally within the power, and a state may prescribe all such regulations as in its judgment will secure, or tend to secure the people against the consequences of fraud."

See also:

In re West, 75 Cal. App. 599.

Appellant, although not setting forth the full ordinance relating to the matter of auctioneering, is content with merely claiming that the ordinance purported to regulate those engaged in the business of auctioneering. He does not deny that he was conducting an auction of $12,000.00 worth of personal property, but claims that since the property belonged to him, that he was not engaged in

the *business* of auctioneering and therefore fell outside of the pale of this particular ordinance. Obviously such a claim is without merit. Any person could merely conduct an auction by the simple subterfuge of purchasing such property as he desired, acquiring title to it and then auctioning the same off as though it were his own.

It has been held that the right to regulate sales of this character includes a person selling his own goods, as well as those of others. Thus in *City of Chicago v. Ornstein,* 154 N. E. 100 (Ill.) the court states:

> "The right to regulate auctioneers has been exercised by the people through their legislators from colonial times to the present and as far as we are aware, has never been questioned. An auctioneer is one who conducts a public sale or auction (Bouvier's Law Dicts.) * * * one who conducts a sale by auction (Standard Dict.) * * * one who invites bids at public auction (Worcesters Dict.). It will be seen that it is immaterial whether the goods sold are those of the auctioneer or of another person who employs the auctioneer. *Goshen v. Kern,* 63 Ind. 468. The object of the regulation is to promote the general welfare by protecting the people from fraudulent sales and this protection is needed as much, if not more, where the auctioneer is selling his own goods as where he is selling the goods of another."

It has been well recognized that auction sales are attended with a greater risk of fraud and possible loss to the public than sales conducted in the ordinary or usual manner.

Saigh v. Common Council (Mich.), 231 N. W. 107;

Robinson v. Wood, 196 N. Y. Supp. 209.

It has been stated by the author of Corpus Juris Secundum, 53 C. J. S. p. 556:

> "* * * Where a statute so intends a single transaction may constitute the carrying on of the business or occupation licensed or taxes."

See:

State v. Mason, 78 P. 2d 920 (Utah).

The same proposition was urged in the case of *Mueller v. Birchfield,* 218 S. W. 2d 180 (Mo.), where the court stated:

> "The question might be raised whether or not the plaintiffs in this transaction were engaged 'in the business of buying, selling, dealing and trading in eggs,' within the meaning of our statute above quoted. We must hold that plaintiffs were 'engaged' in such business under the circumstances in this case, whether the transaction was for the sale of *one* truck load of eggs or for a hundred truck loads of eggs * * *.
>
> "Our statute was plainly for the protection of the people. It was not merely a revenue measure. In the later cases some of the authorities and cases hold that an isolated transaction does not amount to an engagement in the particular business."

It is submitted that in view of the fact that the appellant has failed to set forth the entire ordinance relating to auctioneering, this court must presume that the ordinance in question was both for the purpose of raising revenue and for the protection of the people in the exercise of the legitimate police power and that it was broad enough in its term to include and embrace an operation of the type and character which the appellant attempted

to engage in. It is apparent that Police Officer Lindemulder, the appellee herein, was merely attempting to enforce a valid ordinance of the City of Compton.

POINT TWO.

The Ordinance of the City of Compton Relating to the Requirement of a Business License as an Electrical Contractor, Was Clearly Valid.

Appellant does not claim that he was not in violation of the Compton City Ordinance. His contention apparently is that the Compton ordinance requiring such a license, was and is unconstitutional. Appellant's contention in this regard is utterly without merit. It is asserted that since the appellant was licensed as an electrical contractor by the State of California, that the City of Compton would not have the power or right to require the payment of a business license. This precise contention was laid to rest in the case of *Franklin v. Peterson,* 87 Cal. App. 2d 727. In this case a city license tax had been imposed upon a lawyer authorized to practice by the State Bar of California and who was required to pay an annual fee to the State Bar for his right to practice. It was held that the lawyer was nevertheless subject to the provisions of a local business licensing ordinance.

See also:

City of Corona v. Corona Daily Independent, 115 Cal. App. 2d 382;

Silversten v. City of Menlo Park, 17 Cal. 2d 197;

Ex parte Haskell, 112 Cal. 412;

American Locker Co. v. City of Long Beach, 72 Cal. App. 2d 280.

POINT THREE.

No Cause of Action Has Been Set Forth Under the Civil Rights Acts Of the United States and the District Court Had No Alternative But to Grant the Motion to Dismiss Appellant's Complaint.

The complaint is replete with allegations of bare generalities, and conclusions of law, without supporting factual allegations. Basically in so far as appellee Lindenmulder is concerned, the complaint, stripped of all its excess verbiage reveals no more than that a police officer arrested appellant while the latter was in the process of conducting, contrary to a municipal ordinance, a public auction. Clearly this arrest was made by appellee as a part of his duties as a policeman. He was not responsible for the passage of the ordinance nor could appellee be charged with the duty of passing upon the constitutionality of the ordinance.

The subsequent events following the arrest are those which normally follow any arrest such as finger printing, the taking of pictures and other legitimate police activities. The arrest of appellant on the second charge of failing to have a Compton business license is likewise in the same category. Appellant concedes he had no such license but bravely asserts that the ordinance is unconstitutional. Here again the police officer is in no position to pass on the validity of the ordinance. No system has yet been devised for determining *in advance* the constitutionality of the countless ordinances adopted by municipalities throughout the nation. Obviously some of the ordinances enacted may be declared unconstitutional by the courts. This is the function and the duty of the courts, not of police officers, sworn to enforce the laws.

Directly in point is the case of *Yglesias v. Gulfstream Park Racing Ass'n,* 201 F. 2d 817 (cert. den. in Sup. Ct., 345 U. S. 993; 73 S. Ct. Rep. 1132). In that case the complaint alleged that the various defendants "acting under the color" of the laws of Florida did subject the plaintiff to a deprivation of her rights secured by the constitution and did cause her to be falsely imprisoned without opportunity to confer with counsel and did cause her to be tried before a criminal court without opportunity to prepare for trial. The defendant police officers were alleged to have been a part of a conspiracy to arrest and imprison plaintiff and to deprive her of her civil rights. The District Court dismissed the complaint upon the ground that it failed to state a cause of action. The Circuit Court affirmed this ruling, saying in part, at page 818:

> "What we have in the substantive counts now before us is essentially a charge of false imprisonment, and perhaps malicious prosecution, to which has been added the factually unsupported allegation that plaintiff was thereby deprived of the right to due process, and other rights secured by the Fourteenth Amendment. It may be that the complaint alleges facts sufficient to support an action for false arrest or malicious prosecution. But to show that defendant deprived plaintiff of rights and immunities secured by the Fourteenth Amendment, or caused it to be done, or conspired to that end, plaintiff relies upon bare generalities and conclusions, unsupported by factual allegations. If this is sufficient, then every state court case of false imprisonment may be brought within federal jurisdiction by the mere unsupported assertion that as a consequence of such false imprisonment the plaintiff was deprived of due process, or of other rights secured by the Fourteenth Amendment. The decisions

are to the contrary. It has frequently been held and the rule is recognized in *Bell v. Hood,* 327 U. S. 678, 66 S. Ct. 773, 90 L. Ed. 939, 13 A. L. R. 2d 383, That where the alleged claim under the constitution or federal statutes clearly appears to be colorable, or made solely for the purpose of creating federal jurisdiction over what would otherwise be an action to vindicate a right arising only under state law, and no substantial facts establishing federal jurisdiction are alleged mere conclusions asserting the violation of a constitutional right are insufficient. Lyons v. Weltmer, 4 Cir., 174 F. 2d 473; Taylor v. Smith, 7 Cir., 167 F. 2d 797, 12 A. L. R. 2d 1; note 14 A. L. R. 2d Text page 1100, *et seq.,* McGuire v. Todd, 5 Cir., 198 F. 2d 60, and the many cases cited in Note 5 to that opinion, particularly Givens v. Moll, 5 Cir., 177 F. 2d 765; Bottone v. Lindsley, 10 Cir., 170 F. 2d 705; Moffett v. Commerce Trust Co., 8 State of West Virginia, 4 Cir., 156 F. 2d 739, and the note to Bell v. Hood, 327 U. S. 678, 66 S. Ct. 773, 90 L. Ed. 939, 13 A. L. R. 2d text at page 485. Cf. Adams v. Terry, 5 Cir., 193 F. 2d 600, 605, second column."

With reference to the bulk of the general factually unsupported allegations of appellant's complaint the court stated in McGuire v. Hood, 198 F. 2d 60, at page 63, as follows:

"It is sufficient for us in this case to say: that, as other courts have done, we disregard, as mere conclusions, the loose and general, the factually unsupported, characterizations of the complained of acts of the defendants, as malicious, conspiratorial, and done for the purpose of depriving plaintiffs of their constitutional rights; that the things defendants are alleged to have done, as distinguished from the conclusions of the pleaders with respect to them, do not

> constitute a deprivation of the civil rights of plaintiffs, do not give rise to the cause of action claimed; * * * ."

The same situation clearly appears in the case at bar. It is well settled that "a mere assertion by a plaintiff of entitlement to a Federal remedy does not satisfy Federal jurisdictional requirements, when the facts alleged do not support the assertion."[1] It is also clear that the Fourteenth and Fifteenth Amendments apply only to *state* action, as such, and not to wrongs perpetrated by one individual upon another.[2]

An important case decided by the Circuit Court of Appeals, Ninth Circuit, affirmed a ruling of the Honorable Harry C. Westover, dismissing the plaintiff's complaint because it stated no cause of action under the Civil Rights Acts. In *Dineen v. Williams,* 219 F. 2d 428 (1955) the plaintiff alleged that he had been arrested wrongfully and without probable cause in violation of the Civil Rights Acts. There was no diversity of citizenship involved. The Circuit Court upheld the action of the District Court and stated in part as follows:

> "The complaint stated a claim of false imprisonment cognizable only by state law, * * * But upon its fact the second amended complaint shows that the suggestion of federal jurisdiction was merely colorable and for the purpose of obtaining another forum. It is clear enough from the consideration above that this court finds no claim upon which relief could be granted in a federal court was stated.

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[1]*Brown v. City of Wisner,* La. 122 Fed. Supp. 736, at p. 738. See also *Kilgore v. McKethan,* 205 F. 2d 425.

[2]*Shelley v. Kraemer,* 334 U. S. 1, 3 A. L. R. 2d 441; *Brown v. City of Wisner* (*supra*).

> Since the trial judge obeyed the injunction that such a court should make positive of its power to act at the threshold, on that basis the dismissal is sustained."

It has been stated that "* * * the federal question must be real and substantial not colorable or frivolous. * * * Mere references to the Federal Constitution, laws or treaties and mere assertions that a federal question is involved are not sufficient to confer jurisdiction." *McCartney v. State of West Virginia,* 156 F. 2d 739 at 741.

See generally:

Moffett v. Commerce Trust Co., 187 F. 2d 242;
Gregoire v. Biddle, 177 F. 2d 579;
Campo v. Niemeyer, 182 F. 2d 115;
Bottone v. Lindsley, 170 F. 2d 705;
Love v. Chandler, 124 F. 2d 785.

It is obvious that the acts of the appellee Lindemulder did not deprive the appellant of any rights secured by the Constitution or the laws of the United States. Appellant had no right guaranteed by the Constitution to conduct a public auction, nor did he have any constitutional right to engage in the business of electrical contracting, without first procuring a valid license. It is quite obvious from the long history of litigation that precedes this case, that appellant is thoroughly familiar with the law in its various ramifications and is quite capable of defending himself before any court. He is obviously litigious (see *Agnew v. City of Los Angeles,* 110 Cal. App. 2d 612) and undoubtedly has considerably more experience in the field of constitutional law than appellee, police officer Lindemulder.

To attempt to fasten a civil liability on a police officer under these circumstances, is contrary to basic principles. It is the duty of every police officer to investigate crime and to institute criminal proceedings and in that connection it is settled that it is for the best interests of the community as a whole that he be protected from harassment in the performance of that duty, and public policy requires that he be shielded by the cloak of immunity from civil liability, unless it clearly appears that his conduct has been wilfully violative of some basic right possessed by the appellant.

See:

White v. Towers, 37 Cal. 2d 727;

Coverstone v. Davies, 38 Cal. 2d 315.

Recently a civil rights case was dismissed against a constable for performing his duty in serving a writ upon the plaintiff, the court holding that where the writ appeared valid on its fact, the constable was immune from civil liability.[3] The same principle must be applied to appellee Lindemulder, who was performing his official duty as a police officer.

Conclusion.

It is respectfully submitted that the judgment and order of the trial court was correct and should be affirmed. Appellant has shown no basis for any suit under the Federal Civil Rights Acts. The complaint fails to demonstrate the invalidity of any ordinance or ordinances under which the appellee Lindemulder, as a police officer, re-

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[3]*Thompson v. Baker,* 133 Fed. Supp. 247 (1955).

quired to uphold the laws of the City of Compton, attempted to act. In the absence of a showing of unconstitutionality, every intendment must be in favor of the Compton Municipal Ordinances and the action of the appellee Lindemulder was clearly within his authority as a police officer.

It is respectfully submitted that the judgment should be affirmed.

Respectfully submitted,

REED & KIRTLAND,
F. O. REED,
ROBERT C. PACKARD,
HENRY E. KAPPLER,
Attorneys for Appellee.

No. 15074.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

R. W. AGNEW,

Appellant,

vs.

CITY OF COMPTON, *et al.*,

Appellees.

Appeal From the United States District Court for the Southern District of California, Central Division.

REPLY BRIEF OF APPELLEES.

City of Compton, a Municipal Corporation, and Frank Sprague.

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Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

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TABLE OF AUTHORITIES CITED

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IN THE

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Statement of the Case.

Appellees City of Compton and Frank Sprague adopt in its entirety the statement of the case contained in the Reply Brief of Appellee, H. R. Lindemulder, and in addition thereto, would note additionally that the only reference to Frank Sprague, as alleged in the Complaint, is that said defendant refused to issue an electrical permit to the Appellant, R. W. Agnew, unless said plaintiff first paid his Compton business license.

ARGUMENT.

POINT ONE.

The Complaint Does Not State a Cause of Action Which Would Entitle Him to Jurisdiction in the Federal Court.

It appears on the face of the complaint that the plaintiff and defendants are all citizens of the State of California. [See Tr. pp. 7 and 8, Paras. II, IV, V, VI and VII of the complaint], and diversity of citizenship does not exist.

The defense of lack of jurisdiction over the subject matter, lack of jurisdiction over the person and failure to state a claim which relief can be made by motion. (*Rule 12(b) Federal Rules of Civil Procedure.*)

Diversity of citizenship does not exist where the plaintiff and one of the defendants are citizens and residents of the same state. (*28 U. S. C., Sec. 41(1)(c).*)

While there is an attempt to have pleaded a cause of action under the *Federal Civil Rights Acts* (42 U. S. C. A., Sections 1981 through 1985), stripped of its excess verbiage the complaint does not come within the meaning of those Sections. The instant case is strikingly similar to the *Dinneen v. Williams,* decided by this Court on January 31, 1955, 219 F. 2d 428, where the Court noted that the plaintiff relied on "bare generalities and conclusions unsupported by factual allegations", and "If this is sufficient, then every State Court case of false imprisonment may be brought within Federal jurisdiction by the mere unsupported assertion that as a consequence of such false

imprisonment the plaintiff was deprived of due process, or of other rights secured by the Fourteenth Amendment."

Another strikingly similar case where there was a complaint for damages containing allegations of conspiracy and deprivation of rights secured by the Constitution by causing the plaintiff to be falsely imprisoned for an unreasonable time without bond, and without opportunity to confer with counsel, and where such a complaint was held not to state a cause of action, is *Yglesias v. Gulfstream Park Racing Association* (C. A. Fla.), 201 F. 2d 817, 818, Cert. den. 345 U. S. 993; and similarly, *McNutt v. United Gas, Coke & Chemical Works* (C. A. Ark.), 108 Fed. Supp. 871; and *McGuire v. Todd* (C .A. Tex. 1952), 198 F. 2d 60. Cert. denied 344 U. S. 835.

To open the jurisdiction of the Federal Courts to suits of this nature wherein mere conclusions of law unsubstantiated by any fact indicating a deprivation of a civil right, would make the lower Federal Courts immediate supervisors over every type of State action and State affairs. See the discussion on *The Proper Scope of the Civil Rights Acts,* 66 Harvard Law Review 1285.

As in the *Dinneen* case, *supra,* the suggestion of Federal jurisdiction in the instant case is "merely colorable and for the purpose of obtaining another forum." (See also *McGuire v. Hood,* 198 F. 2d 60.)

POINT TWO.

The Complaint Does Not State a Cause of Action for False Arrest or Malicious Prosecution Against These Appellees.

The plaintiff in the first portion of the complaint attempts to state a cause of action against the City of Compton for false arrest and malicious prosecution. No such attempt is made against the defendant Frank Sprague.

It has been held that a cause of action against a city is not stated by a complaint which charges that the plaintiff was wrongfully confined or that the officers of the city made a false arrest or were guilty of malicious prosecution. (*Oppenheimer v. City of Los Angeles,* 104 Cal. App. 2d 545; *Stedman v. San Francisco,* 63 Cal. 193; *Brindamour v. Murray,* 7 Cal. 2d 73; *Wood v. Cox,* 10 Cal. App. 2d 652; *Abrahamson v. City of Ceres,* 90 Cal. App. 2d 523.)

California Courts have held that a municipal corporation is not liable, in the absence of a special statute rendering it liable, for the torts of its agents in the performance of governmental as distinguished from proprietary functions. (*Henry v. City of Los Angeles,* 114 Cal. App. 2d 603.)

Further, the City Charter of the City of Compton provides:

> "Section 1418. Actions Against City. No suit shall be brought on any claim for money or damages against the city or any board, commission or officer thereof until a demand for the same has been pre-

sented as herein provided and rejected in whole or in part. If rejected in part, suit may be brought to recover the whole. Except in those cases where a shorter time is otherwise provided by law, all claims for damages against the City must be presented within ninety (90) days after the occurrence, event or transaction from which the damages allegedly arose, and all other claims or demands shall be presented within ninety (90) days after the last item of the account or claim accrued.

"In all cases such claims shall be approved or rejected in writing and the date thereof given. Failure to act upon any claim or demand within the sixty (60) days from the date the same is filed with the City Controller shall be deemed a rejection thereof."

At the hearing on the motion to dismiss, no allegation was made of the filing of such a claim, or in the appeal has there been any indication that such a claim has been filed. Such a defect is fatal since the filing of the claim is a condition precedent to the action and a failure to allege such fails to state a cause of action. (*Slavin v. Glendale,* 97 Cal. App. 2d 407; *Kornahrens v. City and County of San Francisco,* 87 Cal. App. 2d 196; *Cathey v. City and County of Los Angeles,* 37 Cal. App. 2d 575.)

POINT THREE.

The Business License Ordinance of the City of Compton Is a Valid Exercise of the Police Power of the City.

The complaint also attempts to set forth a cause of action based on the illegality of the business license ordinance of the City of Compton [Ordinance No. 933, Tr. p. 16; Ordinance No. 941, Tr. p. 17]. It has been held that:

> "A municipality's imposition of a gross receipts tax for revenue, on persons engaged in various businesses and occupations, is strictly a municipal affair within the Const., art. XI, Section 6, as amended in 1914, and is within the authority of a freeholders' charter city whose charter contains no limitations or restriction on its power to levy taxes for revenue purposes."

This has been held true in the matter of lawyers licensed by the State. (*Franklin v. Peterson,* 87 Cal. App. 2d 727; and newspapers, *City of Corona v. Corona Daily Independent,* 115 Cal. App. 2d 382; and physicians, *City of Redding v. Dozier,* 56 Cal. App. 590.)

The Compton License Ordinance does not come within the meaning of *Agnew v. City of Los Angeles,* 110 Cal. App. 2d 612, or the cases cited therein at page 617, in that no additional requirement of contractors other than the payment of a business license is required.

It has been stated that in considering the validity of such an ordinance, the Court must indulge every intendment in favor of its validity, and must resolve all doubts in such a way as to uphold the law-making power. (*Siver-*

sten v. City of Menlo Park, 17 Cal. 2d 197; and *Ex parte Haskell,* 112 Cal. 412.)

A license tax imposing the same amount on all engaged in the same business, regardless of business done or profits received therefrom, is not an unreasonable discrimination against any particular person engaged in the business because its net profit is less than that of others engaged in the same business or because the imposition of the tax may even result in some person engaged in the business operating at a loss. (*American Locker Co. v. City of Long Beach,* 75 Cal. App. 2d 280.) See also as to reasonableness *Mayflower Transit Co. v. Georgia Public Service,* 295 U. S. 285.)

No constitutional rights are violated if the burden of a license tax falls equally on all members of a class, though other classes have lighter burdens or are wholly exempt, provided that the classification is reasonable, based on substantial differences between the pursuits separately grouped, and is not arbitrary. (*Fox Bakersfield Theatre Corporation v. City of Bakersfield,* 36 Cal. 2d 136.)

Conclusion.

That the judgment of the District Court should be upheld and the complaint should be dismissed on the threshold for its failure to state a cause of action against Appellee City of Compton, and Appellee Frank Sprague.

Respectfully submitted,

JAMES G. BUTLER,

Attorney for Appellees, City of Compton, and Frank Sprague.

No. 15076

United States
Court of Appeals
for the Ninth Circuit

RANDALL FOUNDATION, INC.,

Appellant,

vs.

ROBERT A. RIDDELL, Director of Internal Revenue, District of Los Angeles,

Appellee.

Transcript of Record

Appeal from the United States District Court for the Southern District of California, Central Division.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.–5-11-56

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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In the United States District Court, Southern District of California, Central Division

No. 16142-PH

RANDALL FOUNDATION, INC.,

Plaintiff,

vs.

ROBERT A. RIDDELL, Director of Internal Revenue, District of Los Angeles,

Defendant.

COMPLAINT

(To Recover Overpayment of Federal Income Tax)

Comes now the plaintiff, Randall Foundation, Inc., and for its cause of action herein alleges:

I.

Plaintiff is, and at all times herein mentioned has been, a California non-profit corporation, with its principal place of business in Los Angeles County, California. It was formed on or about May 11, 1950. A true and correct copy of its Articles of Incorporation filed with the California Secretary of State at the time of its organization is attached hereto as Exhibit "A." A true and correct copy of a Certificate of Amendment to said Articles filed with the California Secretary of State on October 9, 1952, is attached hereto as Exhibit "B." There have been no other amendments to its Articles of Incorporation, and the Articles as thus amended are presently in effect. [2*]

*Page numbering appearing at foot of page of original Certified Transcript of Record.

II.

Defendant, Robert A. Riddell, is and at all times since December 26, 1952, has been the Director of Internal Revenue for the District of Los Angeles, California.

III.

Plaintiff adopted a fiscal year ended April 30th, and shortly after the close of its first fiscal year ended April 30, 1951, it filed with the Internal Revenue Service an application for exemption from Federal income tax under Section 101(6) of the Internal Revenue Code. Said application was rejected by the said Service on September 12, 1951. Thereafter, plaintiff through its various tax advisers attempted to convince the Service that it was entitled to such tax exemption. Initially, plaintiff was represented by Sidney R. Reed & Co. of Los Angeles. In August, 1952, plaintiff retained the law firm of Barnes and Hill of Washington, D. C., to assist it in these attempts. Plaintiffs efforts were of no avail, and the Service later denied plaintiff's application for exemption under Section 101(6) for its fiscal year ended April 30, 1952. In May, 1953, plaintiff employed the Los Angeles law firm of Gibson, Dunn & Crutcher to assist in its efforts to obtain exemption from Federal income taxes. At that time, plaintiff was faced with a demand of the Director of Internal Revenue of Los Angeles to file corporate income tax returns for its fiscal years ending April 30, 1951, and April 30, 1952, and upon advice of said law firm, plaintiff filed with said Director on June 10, 1953, income tax returns for said year computing

a tax due for the year ended April 30, 1951, of $6,677.13, and for the year ended April 30, 1952, of $14,113.24. The amounts of tax shown due per said returns were paid to said Director on or about June 10, 1953.

IV.

On July 2, 1953, the Director of Internal Revenue at Los Angeles demanded payment of additional tax for the year ended April 30, 1951, in the amount of $14.32, plus penalty for unreasonable delay [3] in filing said return of $1,672.86, plus interest of $497.05. Plaintiff paid these sums on August 18, 1953. Under date of July 2, 1953, the Director of Internal Revenue at Los Angeles demanded payment of additional tax for the year ended April 30, 1952, in the amount of $26.28, plus penalty for unreasonable delay in filing said return of $3,534.88, plus interest of $767.35. Plaintiff paid these sums on August 18, 1953.

V.

Under date of June 12, 1953, plaintiff filed with the Director of Internal Revenue at Los Angeles a claim for refund of tax originally paid for its fiscal year ended April 30, 1951, a true and correct photostatic copy of which (exclusive of four pages thereof appearing thereon under the heading "Statement Attached to Claim for Refund of Income Tax of Randall Foundation, Inc.," which pages are pleaded hereinafter in haec verba) is attached hereto and marked Exhibit "C."

VI.

Under date of June 12, 1953, plaintiff filed with defendant a claim for refund of the tax paid pursu-

ant to its return for the year ended April 30, 1952, a true and correct photostatic copy of which (exclusive of four pages thereof appearing under the heading "Statement Attached to Claim for Refund of Income Tax of Randall Foundation, Inc.," and exclusive of five pages thereof appearing under the heading "Memorandum in Support of Taxpayer's Position" which is identical with the statement under said heading appearing as a part of Exhibit "C" herein) is attached hereto and marked Exhibit "D."

VII.

The claims for refund referred to in paragraphs V and VI above contained the following identical statements appearing under the heading "Statement Attached to Claim for Refund of Income Tax of Randall Foundation, Inc.":

"1. Randall Foundation, Inc., was formed under the non-profit provisions of the California corporation law on May 11, [4] 1950. Its Articles provided that the purpose for which it was formed was to 'aid, assist, contribute to and/or establish charitable, religious and educational institutions, organizations and foundations.' Said Articles also provided that no member should have any interest in the assets of the Foundation nor receive any income or benefit or advantage therefrom, but that, upon any dissolution or winding-up, any assets remaining after payment of debts should be distributed to a religious, educational or charitable organization located in California and selected by the Board of Trustees.

"2. Under date of October 9, 1952, the Articles were amended to provide specifically that 'the specific and primary purpose for which said corporation is formed is to establish a home for underprivileged boys, without regard to race, creed or color. It shall be the purpose of this home to prevent and cure waywardness among boys by providing a wholesome home with facilities for education and the teaching of useful trades or occupations.' Furthermore, the Bylaws were then amended to provide that, if the construction of such a boys' home were not commenced by December 31, 1957, or if facilities for actual residence of at least fifty boys were not established by December 31, 1959, the Trustees must consider appropriate resolutions for the dissolution of the Foundation and the distribution of its assets to an exempt religious, educational or charitable organization. Said Articles and Bylaws have not since been amended.

"3. The income, expenses and gains from disposition and sale of securities of the Foundation for the three years of its existence have been as follows:

	"Year Ended		
	"4/30/51	4/30/52	4/30/53
"Dividends and interest	$10,285.00	$ 7,081.93	$ 2,937.67
"Expenses	1,532.36	8,271.99	5,966.03
"Gains from disposition and sale of securities	30,238.27	51,079.61	5,456.01

"The increase in expenses during the second and third years were largely due to accountants' and legal fees in attempting to secure a ruling as to its tax-free character.

"4. Upon the organization of the Foundation, Paul M. Randall became its president, and the Board of Trustees gave him broad authority over the investment of its assets. Shortly after organization, Mr. Randall contributed to the Foundation the sum of $20,750.11. Thereafter, feeling that he saw investment opportunities which would swell the Foundation's funds, he loaned it considerable funds, the total of said loans during the first year of its existence amounting to $155,200.00. He charged said Foundation 2½% interest on these loans which was the identical interest he was required to pay to borrow the money so loaned to the Foundation. He never made any profit whatsoever on this interest or received any other funds directly or indirectly from the Foundation or its assets.

"5. With the donated and borrowed funds, the Foundation purchased certain investments which were continually supervised and managed by Mr. Randall. Each time he felt there was an opportunity for a profitable transaction, he would cause the Foundation to buy or sell as the case might be. As a result of these transactions, the Foundation's net profit from purchase and sale of assets during the first year of its operation ending April 30, 1951, totaled $30,238.27. None of these transactions was with any 'customer' of Mr. Randall (he was not a broker or dealer in securities) or the Foundation, all of them being made through brokers who purchased or sold for the Foundation either on a listed exchange or an over-the-counter market.

"6. The purpose in forming this non-profit corporation was to create an entity to accomplish various charitable purposes that [6] its organizer, Paul M. Randall, had in mind. The foremost of these was the establishment of a home for underprivileged boys, but upon advice of counsel, the purposes of said Foundation were not so restricted, said purposes embracing any non-profit charitable, religious or educational purpose. Shortly prior to the close of the first year of the Foundation's operation, Mr. Randall had determined definitely that he desired that the funds of the Foundation be dedicated to the eventual establishment of the aforesaid home for underprivileged boys. However, upon advice of tax counsel for the Foundation, Sidney R. Reed & Co., and after discussing this point with them:

"(a) The Foundation contributed to the Children's Hospital Society of Los Angeles $500.00 (out of net profit from operations exclusive of gains from sales of investments of $8,752.64) rather than accumulating it for the establishment of said home because it was felt that some substantial contribution to charity should be made to establish the bona fide character of the Foundation as a charitable organization.

"(b) In filing the request for exemption under Section 101(6) of the Internal Revenue Code on Form 1023, the charitable purposes of the organization were stated in the general terms then contained in its Articles and Bylaws rather than in the specific terms relating to said Boys' home.

"7. The Minutes of the Board of Trustees' meeting held on May 15, 1951, went part way in recognizing formally the specific charitable intention of Mr. Randall, said Minutes containing the following resolution:

" 'That the plan of establishing or selecting some one worthy cause and institution be followed up at this time in view of the earnings of the corporation, in order that a substantial part of the funds of this corporation may be given and invested in a cause in which Mr. Randall of this [7] Foundation and the Foundation of itself may play an important part in the establishment or growth or development thereof.'

"8. In response to the aforesaid application for exemption, the Commissioner of Internal Revenue in Washington ruled on September 12, 1951, that the Foundation was not entitled to an exemption because:

"(a) It had been primarily engaged in the ordinary business of buying and selling securities, it having engaged in 110 different transactions involving the sale or purchase of stock during its first year of operation; and

"(b) The income of the Foundation had not been devoted to the purposes specified in its charter.

"9. During the second fiscal year of the Foundation ending April 30, 1952, it operated in a manner similar to its operations in the first year, with the following exceptions:

"(a) Because of the denial of exemption, Mr. Randall did not feel he was in a position to make substantial contributions to the Foundation, and, therefore, the contributions for the second year amounted to only a few hundred dollars;

"(b) Because of the negative reference to his loans to the Foundation contained in the Commissioner's letter of September 12, 1951, the Foundation repaid prior to the close of its second fiscal year these loans in their entirety;

"(c) The charitable contributions by the Foundation were increased to $11,200.00 (although there was a net loss from operations, exclusive of profits on sale of investments, of $1,190.06), said contributions being made to the following qualified charities:

"Sister Elizabeth Kenny Foundation....	$ 100.00
"St. John's Hospital	1,000.00
"Montecito School for Girls	2,500.00
"David Seabury School of Psye	2,000.00
"Bureau of Welfare-Calif. Teachers Assn.	1,000.00
"American Red Cross	1,000.00
"Y.M.C.A. of South Pasadena	1,000.00
"All Nations Foundation	1,000.00
"Children's Hospital of Los Angeles	500.00
"Girl Scouts of South Pasadena	100.00
"Cate School	1,000.00
"Total	$11,200.00

"10. Subsequent to the first rejection of its claim for exemption under Section 101(6), the Foundation filed several requests for reconsideration, involving both the facts prior to the amendment of the Articles and Bylaws set forth above and the facts subsequent to said amendment. In rulings dated January 15, 1952, June 16, 1952, and January 8, 1953, the Bureau adhered to its original ruling, and in each instance, concluded that the Foundation was not exempt, the latest ruling placing the denial on the ground that the activities of the Foundation had been 'primarily those of an organization engaged in the ordinary business of buying and selling securities.'

"11. As a result of the Bureau's ruling on January 8, 1953, the Director of Internal Revenue at Los Angeles under date of February 26, 1953, requested that income tax returns for prior years be filed and the tax paid. In response to said request, a return for the year in question was filed on June 10, 1953, and the tax computed thereon paid.

"12. It is submitted that the taxpayer was exempt from income tax under Section 101(6) of the I.R.C. for the year in question. A memorandum of points and authorities attached hereto supports this position." [9]

VIII.

All statements contained in the aforesaid claims for refund and set forth in their entirety in Paragraph VII hereof are true and correct.

IX.

Plaintiff was formed and has been operated continuously in good faith exclusively for the charitable purposes set forth in its Articles of Incorporation and the amendment thereto referred to in Paragraph I hereof. Neither Paul M. Randall nor any other Trustee or private person or entity has ever obtained or intended to obtain any profit or advantage directly or indirectly from plaintiff or its operation. There are attached hereto as Exhibits "E" and "F," respectively, schedules containing all sales of securities or property by plaintiff during its fiscal years ended April 30, 1951, and April 30, 1952, respectively. Plaintiff was interested in obtaining as much increment on its funds as possible in order to hasten the day when it could commence its primary charitable objective of providing a home for underprivileged boys. The transactions reflected in Exhibits "E" and "F" hereto were entered into because plaintiff, relying on the judgment of its founder Paul M. Randall, believed that said transactions were for the best interests of plaintiff in that it would result in an increment in its investment portfolio. In certain instances, the frequency of sales was due to the thinness of the market of the particular security involved which necessitated several independent purchases or sales to attain the position which plaintiff felt it should have with respect to that particular security. Neither Paul M. Randall nor any other Trustee of plaintiff or private individual or entity obtained any advantage directly or indirectly from the transactions reflected on said

Exhibits "E" and "F," except that the brokerage houses which handled them were paid their normal commissions.

X.

After the Internal Revenue Service first rejected plaintiff's [10] claim for exemption on September 12, 1951, plaintiff was advised by its Los Angeles tax advisers that it was entitled to said exemption and that attempts should be made to secure a reversal of the adverse ruling of the Commissioner of Internal Revenue. Said attempts were continuously made both by correspondence and one conference in Washington from September 12, 1951, through January 8, 1953, when the latest ruling of the Commissioner reiterating the original ruling with respect to the years ended April 30, 1951, and April 30, 1952, was issued. After receiving the January 8, 1953, letter, plaintiff asked advice as to its appropriate action both from its Washington tax counsel and its tax advisers in Los Angeles. Plaintiff was advised not to proceed until the matter had been studied and further advice given. Such advice was received from its Los Angeles tax advisers on March 3, 1953, but not from its Washington counsel until May 22, 1953, and the advice was conflicting. Thereupon, plaintiff decided to employ additional counsel in Los Angeles, said counsel being employed on or about May 25, 1953. The latter counsel advised that returns should be filed, and returns for the fiscal years ended April 30, 1951, and April 30, 1952, were promptly prepared thereafter and filed on June 10, 1953. Plaintiff's

delay in filing said returns was due to the aforesaid reasonable cause and not to wilful neglect.

XI.

No action has been taken by the Internal Revenue Service with reference to the claims referred to in Paragraphs V and VI hereinabove, and none of the payments referred to in Paragraph III and IV hereinabove have been refunded or credited to the plaintiff.

XII.

The payments referred to in Paragraphs III and IV hereinabove were all made to defendant as Director of Internal Revenue for the District of Los Angeles, and defendant still occupies that position.

Wherefore, plaintiff prays judgment against defendant in the amount of $20,790.37, plus interest as provided by law, and for its [11] costs and disbursements herein, and for such other and further relief as the Court may deem proper.

GIBSON, DUNN &
CRUTCHER,

By /s/ BERT A. LEWIS,
Attorneys for Plaintiff. [12]

EXHIBIT A

Articles of Incorporation of
Randall Foundation, Inc.

Know All Men by These Presents:

That we, the undersigned, a majority of whom are residents of the State of California, do hereby voluntarily associate ourselves together for the purpose of incorporating a non-profit corporation under the laws of the State of California, as set forth in Part I of Division 2 of Title I of the Corporations Code of the State of California, and we do hereby certify that:

I.

The name of said corporation is:

Randall Foundation, Inc.

II.

That the specific and primary purpose for which said corporation is formed is to aid, assist, contribute to and/or establish charitable, religious and educational institutions, organizations and foundations.

III.

That in order to carry out the aforesaid purpose the corporation shall have the power and right to engage in those activities permitted by law to a non-profit corporation organized under the laws of the State of California and under the title aforesaid, and as selected from time to time by the Board of Trustees with a view to creating funds and sources

of revenue for the promotion and advancement of charitable, religious and educational work contemplated by the corporation's primary purpose.

IV.

That the principal office for the transaction of the business of the corporation will be located in the County of Los Angeles, State of California. [13]

V.

That the number of Trustees of said corporation shall be five (5), and the names and residences of the first Trustees, together with the period for which they will serve, is as follows:

Name: Paul Randall.
Period of Service: For Life.
Address: 2050 Fremont Street, South Pasadena, Calif.

Name: Frank R. Randall.
Period of Service: 2 years.
Address: 2050 Fremont Street, South Pasadena, Calif.

Name: Dorothy R. Ward.
Period of Service: 1 year.
Address: 3168 Flower Street, Huntington Park, Calif.

Name: Frederick W. Bailes.
Period of Service: 1 year.
Address: 846 South Sycamore Avenue, Los Angeles, Calif.

Name: James A. Flanagan.
Period of Service: 1 year.
Address: 153 South Camden Drive, Beverly Hills, Calif.

Upon any vacancy occurring on the Board of Trustees for any reason, or upon the termination of the period for which the member serves, the successor Trustee shall be appointed by the founder, Paul Randall, during his lifetime, and thereafter shall be appointed by the remaining Trustees.

VI.

That the Trustees hereunder shall have equal voting power but no individual property rights in or to any assets of the foundation or corporation.

VII.

This corporation is without capital stock, is not organized for profit, and does not contemplate pecuniary gain to the members.

VIII.

No member shall have any proprietary interest whatever in or to any of the assets of the corporation, and no income, increments, or other pecuniary gain, benefit, or advantage of any kind, in any way [14] arising from or growing out of the assets of the corporation or their operation will inure to or in any way go to or vest in any member of the corporation. Upon the dissolution or winding up of the corporation, after paying or adequately providing for the debts and obligations of the corporation,

any remaining assets shall be distributed to a religious, educational or charitable organization located in California and selected by the Board of Trustees.

In Witness Whereof, we, being the original Trustees of said corporation, have hereunto set our hands and seals this 11 day of May, 1950.

/s/ PAUL RANDALL,
/s/ FRANK R. RANDALL,
/s/ DOROTHY R. WARD,
/s/ FREDERICK W. BAILES,
/s/ JAMES A. FLANAGAN. [15]

State of California,
County of Los Angeles—ss.

On this 11 day of May, 1950, before me, Leona J. Moore, a Notary Public in and for said County and State, residing therein, personally appeared Paul Randall, Frank R. Randall, and Dorothy R. Ward, personally known to me to be the persons whose names are subscribed to the foregoing Articles of Incorporation, as incorporators, and who are also named therein as Trustees, and acknowledged to me that they executed the said Instrument.

In Witness Whereof, I have hereunto affixed my hand and official seal this 11 day of May, 1950.

[Seal] LEONA J. MOORE,
Notary Public in and for the County of Los Angeles, State of California. [16]

State of California,
County of Los Angeles—ss.

On this 11 day of May, 1950, before me, Leona J. Moore, a Notary Public in and for said County and State, residing therein, personally appeared Frederick W. Bailes and James A. Flanagan, personally known to me to be the persons whose names are subscribed to the foregoing Articles of Incorporation, as incorporators, and who are also named therein as Trustees, and acknowledged to me that they executed the said Instrument.

In Witness Whereof, I have hereunto affixed my hand and official seal this 11 day of May, 1950.

[Seal] LEONA J. MOORE,
Notary Public in and for the County of Los Angeles, State of California. [17]

EXHIBIT B

Certificate of Amendment of Articles of Incorporation of Randall Foundation, Inc.

The undersigned, Paul Randall, Dorothy R. Ward, Frederick W. Bailes and James A. Flanagan do hereby certify:

One: That the signers hereof constitute at least two-thirds of the incorporators of Randall Foundation, Inc., a California corporation; that Randall Foundation, Inc., is a non-profit non-stock corpora-

tion; that the number of incorporators is five; that there are no members of this corporation other than the incorporators thereof.

Two: That they hereby adopt the following amendments of said articles of incorporation:

(a) Article II of said articles is hereby amended to read as follows:

II.

That the specific and primary purpose for which said corporation is formed is to establish a home for underprivileged boys, without regard to race, creed or color. It shall be the purpose of this home to prevent and cure waywardness among boys by providing a wholesome home with facilities for education and the teaching of useful trades or occupations.

(b) Article III of said articles is hereby amended to read as follows: [18]

III.

That in order to carry out the aforesaid purpose the corporation shall have the power and right to engage in those activities permitted by law to a nonprofit corporation organized under the laws of the State of California under the title aforesaid and under Section 101(6) of the United States Internal Revenue Code and as selected from time to time by the Board of Trustees with a view to creating funds and sources of revenue for the creation and maintenance of the aforesaid home.

(c) Article VIII of said articles is hereby amended to read as follows:

VIII.

No member shall have any proprietary interest whatever in or to any of the assets of the corporation, and no income, increments, or other pecuniary gain, benefit, or advantage of any kind, in any way arising from or growing out of the assets of the corporation or their operation will inure to or in any way to to or vest in any member of the corporation.

The following article is added to the articles of incorporation and designated as Article IX and is to read as follows:

IX.

Upon the dissolution or winding up of the corporation after paying or adequately providing for the debts and obligations of the corporation, any remaining assets shall be distributed to such religious, educational or charitable organizations as may be selected by the Board of Trustees; however, [19] the Board of Trustees may designate only such organizations as are located in the State of California and which qualify as exempt organizations under the provisions of Section 101(6) of the United States Internal Revenue Code.

In Witness Whereof, the undersigned have executed this certificate this 7th day of October, 1952.

/s/ PAUL RANDALL,

/s/ DOROTHY R. WARD,

/s/ FREDERICK W. BAILES. [20]

State of California,
County of Los Angeles—ss.

Paul Randall, Dorothy R. Ward, Frederick W. Bailes and James A. Flanagan, being first duly sworn, each for himself or herself, deposes and says:

That each is one of the incorporators of Randall Foundation, Inc., the California corporation mentioned in the foregoing certificate of amendment; that each has read said certificate and that the statements therein made are true of his own knowledge, and that the signatures purporting to be the signatures of the incorporators thereto are the genuine signatures of said incorporators.

/s/ PAUL RANDALL,

/s/ DOROTHY R. WARD,

/s/ FREDERICK W. BAILES,

/s/ JAMES A. FLANAGAN.

Subscribed and sworn to before me this 7th day of October, 1952.

[Seal] LEONA J. MOORE,
Notary Public in and for Said
County and State. [21]

EXHIBIT C

Form 843

U. S. Treasury Department
Internal Revenue Service
(Revised June, 1951)

Claim

To Be Filed With the Collector Where Assessment Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in, where required, the certificate on the back of this form.

- ☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

[Collector's Stamp]: Received 95—June 12, 1953, Director Int. Rev., Los Angeles, Teller #1.

Notice—Under Reorganization Plan No. 1 of 1952, all references to Collector of Internal Revenue and Deputy Collector now relate to Director of Internal Revenue and Revenue Agent.

Name of taxpayer or purchaser of stamps: Randall Foundation, Inc.

Street address: 2050 So. Fremont Avenue.

City, postal zone and number, and State: South Pasadena, California.

1. District in which return (if any) was filed: Los Angeles, Calif.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from 5/11, 1950, to 4/30, 1951.

3. Kind of tax: Income tax.

4. Amount of assessment, $6,677.13; dates of payment, June 10, 1953.

5. Date stamps were purchased from the Government .....

6. Amount to be refunded: $6,677.13, or such other amount as is legally refundable plus interest as provided by law.

7. Amount to be abated (not applicable to income, estate, or gift taxes).....$.....

The claimant believes that this claim should be allowed for the following reasons:

During the period here in question, taxpayer was a non-profit corporation organized and operated exclusively for religious, charitable, scientific or educational purposes, no part of the net earnings of which inured or could inure to the benefit of any private shareholder or individual and no substantial part of the activities of which was carrying on propaganda or otherwise attempting to influence legislation. It was, therefore, exempt from Federal income tax under the provisions of Sec. 101(6) of the I.R.C., and the above income tax for said year

assessed against it was erroneously assessed and should be refunded.

Without limiting the generality of the foregoing ground for refund, there is attached hereto a statement setting forth in some detail the organization and operation of the taxpayer, the history of its attempts to secure a ruling of exempt status from the Bureau of Internal Revenue, and some of the reasons and authorities supporting taxpayer's position that, contrary to the prior Bureau rulings, during the year here in question it was exempt and is entitled to the claimed refund.

I declare under the penalities of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Signed:

RANDALL FOUNDATION, INC.

By /s/ PAUL M. RANDALL,
President.

Dated: 6/12, 1953. [22]

Memorandum in Support of Taxpayer's Position

The principal basis for the Bureau's action in denying prior requests for exemption was the fact that the Foundation had engaged in many purchases and sales of stocks and securities during each year

which the Bureau felt constituted the carrying out of a trade or business.

It is submitted that such a position is erroneous and that such activity does not properly affect the exempt status of the Foundation:

1. As to the year beginning with organization May 11, 1950, and ending April 30, 1951:

(a) Such activity does not constitute the carrying out of a trade or business. A constant stream of changes of a person's investments for his own account does not constitute engaging in a trade or business, regardless of the number of transactions. Commissioner v. Burnett, 118 Fed. (2d) 659 (C.C.A. 5th, 1941). (During the year, there were 584 transactions, both in stocks and commodities on margin.) Higgins v. Commissioner, 312 U. S. 212 (1940), where the Government contended that "mere personal investment activities never constitute carrying on a trade or business, no matter how much of one's time or of one's employee's time they may occupy." The Supreme Court, in affirming the Tax Court's holding that the investor was not engaged in trade or business, stated: [23]

> "No matter how large the estate or how continuous or extended the work required may be, such facts are not sufficient as a matter of law to permit the Courts to reverse the decision of the Board."

Kane v. Commissioner, 100 Fed. (2d) 382, (C.C.A. 2nd, 1938), where investor was held not to be en-

gaged in trade or business notwithstanding evidence to the effect that he "changed investments continually."

(b) Even if, contrary to the above law, such activity did constitute the carrying out of a trade or business, that fact would not affect the otherwise exempt character of the Foundation:

(i) Since sales were made on the exchange and not to customers, the Foundation was clearly not a "dealer in securities."

Pacific Affiliates, Inc.,
18 T. C. 1175 at 1212 (1952).

George R. Kemon,
16 T. C. 1026 (1951).

Commissioner v. Burnett,
118 Fed. (2d) 659, (C.C.A. 5th 1941).

Such gains, therefore, were not taxable as unrelated business income under Section 422(a) (5) of the I.R.C. Furthermore, since Mr. Randall received no consideration from the Foundation for his services in determining and carrying out its investment policies, including purchases and sales, such income would also not be unrelated business income because of the provisions of Section 422(b) (1). Since for these two independent reasons the income would not be taxable as unrelated business income, Section 302 [24] (a) of the Revenue Act of 1950 applies and precludes the denial of exemption because of any such trade or business.

(c) Under Section 303 of the Revenue Act of 1950, the law with respect to the taxability of feeder organizations as applicable to taxable years beginning prior to December 31, 1950, was specifically not affected by the provisions of the 1950 Act. Under such law, so long as the funds of the organization were dedicated to the requisite charitable purpose, it was immaterial that the organization earned income from the operation of the business:

Roche's Beach, Inc., v. Commissioner,
96 Fed. (2d) 776, (C.C.A. 2nd 1938).

Trinidad v. Sagrada Orden De Predicadores,
263 U. S. 578, (1923).

Willingham v. Home Oil Mill,
181 Fed. (2d) 9, (C.C.A. 5th 1950).

C. F. Mueller Co. v. Commissioner,
190 Fed. (2d) 120, (C.C.A. 3rd 1951).

The Jack Little Foundation v. Jones,
102 F. Supp. 326, (W.D. Okla. 1951).

Sico Company v. United States,
102 F. Supp. 196, (Ct. Clms. 1952).

Even in the Tax Court decisions which have held to the contrary they have stressed the fact that the business involved competed with other businesses which were subject to taxes.

There is obviously no competition with private enterprise in the instant case since the sales were made not to customers but [25] through regular stock exchanges.

2. As to the year ended April 30, 1952:

(a) Such activity does not constitute the carrying out of a trade or business. A constant stream of changes of a person's investments for his own account does not constitute engaging in a trade or business, regardless of the number of transactions. Commissioner v. Burnett, 118 Fed. (2d) 659, (C.C.A. 5th, 1941). (During the year, there were 584 transactions, both in stocks and commodities on margin.) Higgins v. Commissioner, 312 U. S. 212 (1940), where the Government contended that "mere personal investment activities never constitute carrying on a trade or business, no matter how much of one's time or of one's employee's time they may occupy." The Supreme Court, in affirming the Tax Court's holding that the investor was not engaged in trade or business, stated:

> "No matter how large the estate or how continuous or extended the work required may be, such facts are not sufficient as a matter of law to permit the Courts to reverse the decision of the Board."

Kane v. Comissioner, 100 Fed. (2d) 382, (C.C.A. 2nd, 1938), where investor was held not to be engaged in trade or business notwithstanding evidence to the effect that he "changed investments continually."

(b) Even if, contrary to the above law, the investment activity is considered to constitute a trade

or business, it is clear that the Foundation was not organized or operated for the "primary purpose" of carrying on a trade or business as [26] that phrase is used in the second to the last paragraph of Section 101 as added by the 1950 Revenue Act. That phrase was obviously intended to refer to the situations mentioned by the committees in their reports on this addition—automobile businesses, spaghetti factories, and the like, which were either contributed or sold to a non-profit organization. In contrast in the instant case, income producing investments were given to the Foundation and the fact that there were many conversions and reinvestments of said funds can hardly sustain the proposition that the primary purpose of the Foundation was the operation of a trade or business. The founder has always had a specific charitable project in mind and the Foundation is working diligently to secure the necessary funds to accomplish that charitable purpose.

(c) There was no unreasonable accumulation of the Foundation's income within the meaning of Section 3814 for the year in question since its charitable contributions substantially exceeded the excess of its ordinary income over its expenses, and, the proceeds from the sales of its investments were promptly reinvested in other securities held in good faith for the product of investment income. Thus, such profits are eliminated in considering whether an accumulation is unreasonable.

Regulation 111, Section 29.3814-1.

Furthermore, the charitable contributions paid out by the Foundation during the first two years of its existence exceeded the excess of its ordinary income over its expenses for those years. [27]

EXHIBIT D

Form 843

U. S. Treasury Department
Internal Revenue Service
(Revised June, 1951)

Claim

To Be Filed With the Collector Where Assessment Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in, where required, the certificate on the back of this form.

- ☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

[Collector's Stamp]: Received 95—June 12, 1953, Director Int. Rev., Los Angeles, Teller #1.

Name of taxpayer or purchaser of stamps: Randall Foundation, Inc.

Street address: 2050 So. Fremont Avenue.

City, postal zone number, and State: South Pasadena, California.

1. District in which return (if any) was filed: Los Angeles, Calif.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from 5/1/51, to 4/30/52.

3. Kind of tax: Income tax.

4. Amount of assessment, $14,113.24; dates of payment, June 10, 1953.

5. Date stamps were purchased from the Government .....

6. Amount to be refunded $14,113.24, or such other amount as is legally refundable plus interest as provided by law.

7. Amount to be abated (not applicable to income, estate, or gift taxes).....$.....

The claimant believes that this claim should be allowed for the following reasons:

During the period here in question, taxpayer was a non-profit corporation organized and operated exclusively for religious, charitable, scientific or educational purposes, no part of the net earnings of which inured or could inure to the benefit of any private shareholder or individual and no substantial part of the activities of which was carrying on

propaganda or otherwise attempting to influence legislation. During the year in question, the taxpayer engaged in no prohibited transactions as defined in Sec. 3813 of the I.R.C. and did not engage in any practices prohibited by Sec. 3814 of the I.R.C. Thus, it was exempt from income tax for said year.

Without limiting the generality of the foregoing ground for refund, there is attached hereto a statement setting forth in some detail the organization and operation of the taxpayer, the history of its attempts to secure a ruling of exempt status from the Bureau of Internal Revenue, and some of the reasons and authorities supporting taxpayer's position that, contrary to the prior Bureau rulings, during the year in question it was exempt and is entitled to the claimed refund.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Signed:

RANDALL FOUNDATION, INC.

By /s/ PAUL M. RANDALL, President.

Dated: 6/12/1953. [28]

EXHIBIT E

Randall Foundation—Sales of Stock

	Date Acquired	Date Sold	Shares	Sales Price	Cost	Gain or Loss
Bandini Petroleum Company	5/31/50	11/ 2/50	200	$ 905.62	$ 1,297.76	$ (392.14)
	5/31/50	11/ 2/50	100	465.19	648.88	(183.69)
Totals			300	$ 1,370.81	$ 1,946.64	$ (575.83)
Barker Bros., Inc.	6/19/50	7/ 5/50	100	$ 1,677.96	$ 1,819.00	$ (141.04)
	6/20/50	8/11/50	100	1,680.96	1,831.56	(150.60)
	6/20/50	8/24/50	100	1,864.52	1,831.56	32.96
			300	$ 5,223.44	$ 5,482.12	$ (258.68)
Bishop Oil Company	6/21/50	7/19/50	100	$ 1,233.62	$ 1,404.44	$ (170.82)
	6/29/50	7/19/50	100	1,233.62	1,216.00	17.62
	7/18/50	7/19/50	100	1,283.37	1,115.50	167.87
	7/18/50	7/19/50	100	1,283.37	1,115.50	167.87
	7/28/50	8/10/50	100	1,556.98	1,492.38	64.60
	7/28/50	10/ 4/50	100	1,171.43	1,492.38	(320.95)
	7/28/50	10/ 4/50	100	1,171.43	1,492.38	(320.95)
	8/17/50	10/11/50	100	1,283.37	1,504.94	(221.57)
	8/23/50	1/18/51	100	1,345.56	1,517.50	(171.94)
	8/24/50	1/18/51	100	1,345.56	1,442.13	(96.57)
	8/24/50	1/19/51	100	1,382.85	1,442.13	(59.28)
	8/24/50	1/19/51	100	1,382.87	1,442.13	(59.26)
	8/24/50	1/19/51	100	1,382.87	1,429.56	(46.69)
	8/25/50	1/19/51	100	1,382.87	1,391.88	(9.01)
	9/ 5/50	1/19/51	100	1,382.87	1,379.31	3.56
	9/ 6/50	1/19/51	100	1,382.88	1,366.75	16.13
	9/ 7/50	1/19/51	100	1,382.87	1,354.19	28.68
	9/ 8/50	1/19/51	400	5,531.48	5,366.52	164.96
	10/25/50	1/19/51	100	1,382.87	1,216.00	166.87
	11/30/50	1/19/51	100	1,382.87	1,065.25	317.62
	11/30/50	2/16/51	100	1,432.62	1,065.25	367.37
	12/ 4/50	4/16/51	100	1,134.12	1,015.00	119.12
	12/13/50	4/24/51	100	1,158.99	977.13	181.86
	12/14/50	4/30/51	100	1,208.74	951.88	256.86
			2,700	$ 35,820.08	$ 35,256.13	$ 563.95
Bolsa Chica Oil Company	12/ 8/50	2/ 2/51	100	$ 601.30	$ 484.75	$ 116.55
Calavares Cement Company	6/30/50	8/29/50	100	$ 1,432.47	$ 1,643.13	$ (210.66)
	7/ 6/50	8/29/50	100	1,444.91	1,542.63	(97.72)
	8/15/50	9/ 7/50	100	1,531.96	1,417.00	114.96
	8/15/50	9/14/50	100	1,805.58	1,417.00	388.58
	8/16/50	2/19/51	100	1,730.96	1,404.44	326.52
			500	$ 7,945.88	$ 7,424.20	$ 521.68
Cities Service Corporation	7/17/50	7/25/50	50	$ 3,591.37	$ 3,317.87	$ 273.50
	4/ 5/51	4/12/51	100	8,735.44	8,446.91	288.53
	4/24/51	4/16/51	75	6,510.84	6,901.95	(391.11)
			225	$ 18,837.65	$ 18,666.73	$ 170.92

Randall Foundation—Sales of Stock—(Continued)

	Date Acquired	Date Sold	Shares	Sales Price	Cost	Gain or Loss
Douglas Oil Company	12/18/50	3/ 1/51	875	$ 2,263.19	$ 1,780.63	$ 482.56
	12/20/50	3/ 1/51	125	323.31	254.38	68.93
			1,000	$ 2,586.50	$ 2,035.01	$ 551.49
Exeter Oil Company Class A	8/29/50	2/ 9/51	1,200	$ 958.18	$ 731.40	$ 226.78
	8/31/50	2/ 9/51	400	319.40	243.80	75.60
	9/ 6/50	2/ 9/51	100	79.84	60.95	18.89
	9/ 7/50	2/ 9/51	200	159.70	121.90	37.80
	9/ 8/50	2/ 9/51	100	79.84	60.95	18.89
	9/26/50	2/ 9/51	100	79.84	58.30	21.54
	10/3/50	2/ 9/51	200	159.70	116.60	43.10
	10/ 5/50	2/ 9/51	400	319.40	233.20	86.20
	10/ 9/50	2/ 9/51	300	239.54	174.90	64.64
			3,000	$ 2,395.44	$ 1,802.00	$ 593.44
						*(Short Sale)
Fullerton Oil Company	12/ 5/50	12/ 5/50	100	$ 3,099.94	$ 3,099.94	**$ 0
General Exploration Company	10/ 2/50	1/24/51	100	$ 992.45	$ 925.00	$ 67.45
	1/30/51	1/25/51	100	1,004.95	1,004.95	** 0
	1/30/51	1/29/51	100	1,029.95	1,029.95	** 0
	2/13/51	2/13/51	100	1,291.70	1,291.70	** 0
			400	$ 4,319.05	$ 4,251.60	$ 67.45
General Motors Corporation	4/24/51	4/16/51	50	$ 2,570.84	$ 2,689.94	*$ (119.10)
Long Bell Lumber Co.—Class A	8/17/50	11/ 2/50	100	$ 2,641.56	$ 2,773.75	$ (132.19)
	9/11/50	11/ 2/50	100	2,654.00	2,673.25	(19.25)
	11/15/50	10/30/50	100	1,992.14	1,787.50	* 204.64
	11/21/50	10/30/50	100	1,992.14	1,775.00	* 217.14
	10/ 6/50	11/15/50	100	2,355.51	2,811.44	(455.93)
	10/10/50	11/27/50	100	2,330.64	2,761.19	(430.55)
	10/11/50	12/ 4/50	100	2,268.45	2,698.38	(429.93)
	10/13/50	12/ 8/50	100	2,392.82	2,660.69	(267.87)
	10/16/50	1/ 4/51	100	2,741.06	2,597.88	143.18
	10/27/50	1/ 4/51	100	2,666.44	2,535.06	131.38
	10/30/50	1/ 9/51	100	2,905.85	2,623.00	282.85
			1,100	$ 26,940.61	$ 27,697.14	$ (756.53)
Long Bell Lumber Co.—Class B	4/11/51	4/11/51	100	$ 554.35	$ 500.00	$ 54.35
Los Angeles Investment Company	2/20/51	4/ 2/51	10	$ 3,483.33	$ 3,466.00	$ 17.33
Nash Kelvinator Corporation	6/29/50	7/ 3/50	100	$ 1,867.77	$ 1,831.56	$ 36.21

*(Short Sale)
**(Donation)

Randall Foundation—Sales of Stock—(Continued)

	Date Acquired	Date Sold	Shares	Sales Price	Cost	Gain or Loss
Nordon Corporation	12/21/50	2/16/51	2,000	$ 278.99	$ 154.00	$ 124.99
	4/19/51	4/19/51	4,000	1,077.96	1,077.96 **	0
	4/19/51	4/20/51	3,000	838.47	838.47 **	0
	4/26/51	4/27/51	1,000	249.49	249.49 **	0
			10,000	$ 2,444.91	$ 2,319.92	$ 124.99
Reserve Oil and Gas Company	6/12/50	6/12/50	200	$ 3,574.26	$ 3,574.26 **	$ 0
Signal Oil and Gas Co.—Class A	8/16/50	8/21/50	100	$ 5,543.00	$ 5,581.55	$ (38.55)
	9/20/50	9/22/50	100	5,955.09	5,856.83	98.26
	12/13/50	11/28/50	100	6,092.44	6,092.44 **	0
	1/12/51	1/10/51	100	7,066.45	7,033.00	33.45
			400	$ 24,656.98	$ 24,563.82	$ 93.16
Southern Calif. Petroleum Co.	11/10/50	11/24/50	100	$ 1,482.36	$ 1,366.75	$ 115.61
	12/29/50	2/16/51	100	1,930.11	1,442.13	487.98
			200	$ 3,412.47	$ 2,808.88	$ 603.59
Toledo Edison Company	7/10/50	7/13/50	250	$ 2,492.95	$ 2,492.95 **	0
Universal Consolidated Oil Co.	6/ 1/50	8/10/50	50	$ 2,908.07	$ 2,563.63	$ 344.44
	6/ 9/50	8/ 9/50	100	5,816.15	5,131.10	685.05
	6/15/50	8/10/50	200	11,734.76	10,562.50	1,172.26
	6/16/50	8/17/50	100	6,142.09	5,327.75	814.34
	6/27/50	8/31/50	100	5,667.58	5,331.30	336.28
	6/29/50	8/10/50	50	2,920.54	2,632.55	287.99
	6/30/50	8/14/50	50	2,957.95	2,576.16	381.79
	7/ 3/50	8/31/50	50	2,839.50	2,526.83	312.67
	7/ 5/50	8/31/50	50	2,839.50	2,426.38	413.12
	7/ 5/50	11/28/50	50	2,833.26	2,488.44	344.82
	7/25/50	9/ 6/50	100	5,767.48	5,031.00	736.48
	7/25/50	9/ 6/50	100	5,667.58	5,227.50	440.08
	7/27/50	11/28/50	50	2,833.26	2,665.65	167.61
	7/27/50	4/19/51	50	4,082.11	2,665.65	1,416.46
	8/21/50	4/19/51	100	8,264.93	6,054.56	2,210.37
	10/20/50	4/20/51	50	4,229.73	2,828.18	1,401.55
	10/23/50	4/19/51	100	8,165.03	5,731.70	2,433.33
	11/ 2/50	4/19/51	100	8,060.47	5,831.80	2,228.67
	11/ 2/50	4/24/51	100	8,464.73	5,831.80	2,632.93
	2/20/51	2/28/51	50	4,113.28	3,866.88	246.40
	3/21/51	4/10/51	50	3,982.37	4,017.25	(34.88)
	4/ 9/51	4/19/51	50	3,980.37	3,967.13	13.24
	11/ 6/50	3/28/51	100	7,960.74	5,829.00	2,131.74
	11/16/50	3/29/51	50	3,882.62	2,815.80	1,066.82
	11/16/50	4/16/51	50	3,831.12	2,815.80	1,015.32
	12/ 8/50	4/16/51	50	3,831.12	2,663.59	1,167.53
	12/11/50	4/17/51	50	3,907.55	2,695.00	1,212.55
	12/27/50	4/17/51	50	3,907.55	2,889.44	1,018.11
	12/28/50	4/16/51	100	7,715.36	5,879.13	1,836.23
			2,150	$149,306.80	$120,873.50	$ 28,433.30
Grand Totals			23,185	$303,505.36	$273,267.09	$ 30,238.27

**(Donation)

EXHIBIT F

Randall Foundation, Inc.—Sales of Capital Assets

Year 1951 Return

Fiscal Year May 1, 1951 to April 30, 1952

P.V. or No. of Shares		Date Acquired	Date Sold	Sales Price	Cost	Federal Less Than 6 Months Gain	Federal Less Than 6 Months Loss	Federal More Than 6 Months Gain	Federal More Than 6 Months Loss
200	Bandini Petroleum Co.	6/19/50	11/30/51	$ 658.12	$ 1,398.76				$ 740.64
100	" " "	6/27/50	12/14/51	329.06	674.13				345.07
300	" " "	7 12/50	12/14/51	950.08	1,580.51				630.43
100	" " "	8/ 3/50	12/14/51	316.69	648.88				332.19
200	" " "	8/ 8/50	12/14/51	633.38	1,323.00				689.62
100	" " "	8/10 50	12/14/51	316.69	661.50				344.81
200	" " "	5/31/50	12/14/51	633.38	1,297.76				664.38
100	" " "	11/ 9/50	12/14/51	316.69	434.25				117.56
100	" " "	11/15/50	12/14/51	316.69	421.63				104.94
300	" " "	11/29/50	12/14/51	950.07	1,340.64				390.57
100	" " "	2/ 2/51	12/14/51	316.69	396.38				79.69
300	" " "	2/ 9/51	12/14/51	950.07	1,189.14				239.07
500	" " "	2 15/51	12/14/51	1,583.52	1,981.90				398.38
100	" " "	12/13/50	8/30/51	366.19	371.13				4.94
100	" " "	5/23/51	8/31/51	366.19	371.13		$ 4.94		
100	" " "	6/ 1/51	9/24/51	390.94	358.50	$ 32.44			
100	" " "	6/ 1/51	12/12/51	341.44	358.50				17.06
100	" " "	7/17/51	12/20/51	378.56	409.00		30.44		
100	" " "	8/16/51	12/26/51	353.81	345.88	7.93			
3,200	" " "			$ 10,468.26	$ 15,562.62	$ 40.37	$ 35.38		$ 5,099.35
100	Bishop Oil Co.	11/ 7/51	11/13/51	$ 1,196.31	$ 1,203.89		$ 7.58		
200	" " "	12/14/50	5/23/51	2,405.05	1,891.13	$ 513.92			
100	" " "	12/15/50	10/ 5/51	1,308.24	939.25			$ 368.99	
200	" " "	12/15/50	11/ 7/51	2,293.12	1,853.25			439.87	
100	" " "	12/29/50	12/14/51	1,221.18	1,140.63			80.55	
100	" " "	1/ 5/51	1/23/52	1,357.99	1,190.88			167.11	
200	" " "	1/14/51	1/29/52	2,660.80	2,331.50			329.30	
15	" " "	2/26/51	1/29/52	199.71	205.01				$ 5.30
100	" " "	2/26/51	1/29/52	1,333.12	1,366.94				33.82
200	" " "	3/ 2/51	1/29/52	2,666.24	2,619.65			46.59	
100	" " "	3/ 2/51	1/29/52	1,333.12	1,269.36			63.76	
200	" " "	3/15/51	6/22/51	2,591.62	2,532.50	59.12			
100	" " "	3/ 5/51	7/ 2/51	1,258.49	1,228.56	29.93			
100	" " "	6/ 5/51	9/12/51	1,382.87	1,190.88	191.99			
100	" " "	7/ 2/51	10/ 4/51	1,308.24	1,153.19	155.05			
200	" " "	8/27/51	10/ 4/51	2,616.48	2,633.00		16.52		
100	" " "	9/11/51	10/ 4/51	1,308.24	1,303.94	4.30			
100	" " "	10 2/51	10/23/51	1,246.06	1,379.31		133.25		
100	" " "	10/29/51	10/23/51	1,246.06	1,216.45	29.61			
100	" " "	6/15/51	1/31/52	1,379.31	1,175.17			204.14	
2,515				$ 32,312.25	$ 29,824.49	$ 983.92	$ 157.35	$ 1,700.31	$ 39.12
100	Allen B. Dumont Laboratories	5/18/51	2/ 4/52	$ 1,765.44	$ 1,643.56			$ 121.88	
100	Balsa Chica Oil	12/10/51	2/13/52	477.56	560.50		$ 82.94		
100	Balsa Chica Oil	11/10/51	2/13/52	477.56	636.25		158.69		
120	Calavares Cement Co.	9/14/50	6/ 5/51	1,817.23	1,731.06			86.17	
50	Chrysler Corp.	5/10/51	6/ 7/51	3,522.17	3,925.78		403.61		
50	Chrysler Corp.	5/21/51	2/ 5/52	3,416.40	3,719.53				$ 303.13
50	Cities Service Corp.	5/29/51	6/ 7/51	5,016.34	4,900.30	$ 116.04			
				$ 16,492.70	$ 17,116.98	$ 116.04	$ 645.24	$ 208.05	$ 303.13

1,075	Douglas Oil Co.—Common	Various	Various	$ 2,938.04	$ 2,125.12					$ 812.92			
11	" " " "	5/21/51	10/25/51	31.49	23.07	$ 8.42							
325	" " " "	5/21/51	12/14/51	961.84	681.43					280.41			
100	" " " "	6/20/51	12/14/51	295.95	203.50	92.45							
100	" " " "	6/20/51	12/10/51	295.95	203.50	92.45							
1,300	" " " "	6/25/51	1/ 9/52	3,996.00	2,645.50					1,350.50			
200	" " " "	12/12/51	1/28/52	728.80	583.00	145.80							
450	" " " "	12/14/52	1/28/52	1,639.80	1,298.25	341.55							
3,561				$ 10,887.87	$ 7,763.37	$ 680.67				$ 2,443.83			
100	General Exploration Co.	8/24/51	9/ 4/51	$ 812.50	$ 756.25	$ 56.25							
50	Hancock Oil Co—"A"	10/26/51	10/19/51	14,971.70	14,975.00		*$	3.30					
50	Hancock Oil Co.—"A"	10/29/51	10/23/51	15,446.69	15,025.00	* 421.69							
100	Hudson Motor Car	3/ 7/51	12/ 5/51	1,320.13	1,957.19							$	637.06
100	Hudson Motor Car	11/21/51	12/ 5/51	1,320.13	1,241.13	79.00							
300	Hudson Motor Car	11/21/51	12/18/51	3,764.82	3,723.39	41.43							
100	International Tel. & Tel. Co.	5/23/51	9/21/51	1,813.27	1,530.06	283.21							
100	International Tel. & Tel. Co.	5/10/51	9/17/51	1,713.77	1,618.00	95.77							
50	Nash Kelvinator	6/19/51	4/27/51	977.96	956.90	* 21.06							
3,000	Nordon Corp.	6/19/51	5/16/51	628.47	420.00	* 208.47							
1,000	Nordon Corp.	1/29/52	10/26/51	229.49	190.00	* 39.49							
3,000	Nordon Corp.	Various	Various	618.47	618.47	**							
50	Northern Pacific Railway	1/ 7/52	12/10/51	3,177.58	3,163.62	* 13.96							
3,000	Oceanic Oil Co.	Various	Various	6,377.38	5,957.50					$ 419.88			
1,000	Oceanic Oil Co.	5/ 1/51	8/20/51	1,855.21	1,691.25	163.96							
100	Pacific Mutual Life Ins. Co.	5/22/51	4/10/52	482.51	831.60								349.09
100	Signal Oil & Gas Co.—Class A	5/22/51	8/29/51	8,564.92	7,733.70	831.22							
100	" " " " " "	6/27/51	8/29/51	8,639.84	7,633.60	1,006.24							
100	" " " " " "	8/ 1/51	8/21/51	8,340.15	7,558.53	781.62							
100	" " " " " "	10/ 9/51	9/19/51	9,663.80	9,385.35	* 278.45							
100	" " " " " "	6/27/51	8/ 8/51	8,215.28	7,633.60	581.68							
100	" " " " " "	10/ 9/51	9/18/51	9,301.67	9,385.35		*	83.68					
				$108,235.74	$103,985.49	$ 4,903.50	$	86.98		$ 419.88		$	986.15
Option	Universal Consolidated Oil Co.		5/31/51	$ 2,220.00		$ 2,220.00							
950	" " " "	Various	Various	83,342.10	$ 56,720.30	26,621.80							
50	" " " "	1/ 9/51	10/24/51	3,982.37	3,190.19					$ 792.18			
50	" " " "	1/ 9/51	10/24/51	3,980.37	3,190.19					790.18			
50	" " " "	1/14/51	11/ 1/51	3,899.62	3,190.19					709.43			
50	" " " "	1/14/51	11/ 5/51	4,007.29	3,165.13					842.16			
100	" " " "	1/14/51	11/ 7/51	7,965.24	6,330.25					1,634.99			
500	" " " "	Various	Various	39,650.11	42,501.77							$	2,851.66
50	" " " "	12/ 3/51	2/ 5/51	3,982.37	3,566.13	416.24							
50	" " " "	12/ 4/51	2/ 5/51	3,982.37	3,516.00	466.37							
500	" " " "	Various	Various	42,946.98	31,170.71	12,776.27							
100	" " " "	1/15/51	9/21/51	7,989.67	6,430.50					1,559.17			
200	" " " "	1/15/51	10/31/51	16,330.99	12,861.00					2,469.99			
50	" " " "	4/25/51	11/ 2/51	3,955.43	4,217.75								262.32
50	" " " "	4/14/51	11/16/51	3,633.24	3,942.83								309.59
50	" " " "	6/27/51	12/ 4/51	3,583.37	4,267.88		$	684.51					
200	" " " "	Various	2/ 5/52	16,002.27	17,234.41								1,232.14
100	" " " "	11/ 6/50	5/ 1/51	8,559.22	7,934.25	624.97							
3,100				$260,013.01	$213,429.48	$43,125.65	$	684.51		$ 8,798.10		$	4,655.71
50	U. S. Smelting and Refining Co.	4/27/51	6/ 7/51	$ 2,606.85	$ 2,690.68		$	83.83					
50	U. S. Smelting and Refining Co.	4/27/51	6/22/51	2,718.84	2,690.67	$ 28.17							
100	U. S. Smelting and Refining Co.	5/23/51	8/ 2/51	5,611.23	5,181.15	430.08							
50	U. S. Steel Corp.	5/21/51	4/16/51	2,032.78	2,196.79		*	126.51					
100	Weststates Petroleum—Preferred	12/ 6/50	6/ 7/51	601.30	459.50					$ 141.80			
				$ 13,571.00	$ 13,218.79	$ 458.25	$	247.84		$ 141.80			
	Grand Totals			$451,980.83	$400,901.22	$50,308.40	$ 1,857.30			$13,711.97		$11,083.46	
	Less Total Loss			400,901.22		1,857.30				11,083.46			
	Net Gain			$ 51,079.61		$48,451.10				$ 2,628.51			

Affidavit of Service by Mail attached.
[Endorsed]: Filed December 18, 1953.

*(Short Sale)
**(Donation)

[Title of District Court and Cause.]

ANSWER

Comes Now the defendant in the above-entitled action and, in answer to plaintiff's complaint, admits, denies and alleges:

I.

Defendant denies the allegations contained in paragraph I of plaintiff's complaint, except it is admitted that plaintiff is a California corporation with its principal place of business in Los Angeles County, California; it is further admitted that the corporation was formed on or about May 11, 1950.

II.

Admits the allegations contained in paragraph II thereof.

III.

Defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph III of plaintiff's complaint, except it is admitted that plaintiff filed with the Internal Revenue Service an application for exemption from federal income tax under Section 101(6) of the Internal Revenue Code and that said application was rejected by the Internal Revenue Service on September 12, 1951; it is further admitted that the [38] Director of Internal Revenue of Los Angeles demanded that plaintiff file corporate income tax returns for its fiscal years ending April 30, 1951, and April 30, 1952, and that plaintiff filed with said Director, on June 10, 1953, income

tax returns for the year ending April 30, 1951, paying a tax thereon of $6,677.13, and for the year ending April 30, 1952, paying a tax thereon of $14,113.24.

IV.

Defendant denies the allegations contained in paragraph IV of plaintiff's complaint, except it is admitted that on August 21, 1953, plaintiff paid an additional tax for the year ending April 30, 1951, in the amount of $2,184.23, and for the year ending April 30, 1952, additional tax in the amount of $4,328.51.

V.

Defendant denies the allegations contained in paragraph V of plaintiff's complaint, except it is admitted that on June 12, 1953, plaintiff filed with defendant a claim for refund for its fiscal year ending April 30, 1951; it is also admitted that a copy of said claim (exclusive of four pages headed "Statement Attached to Claim for Refund of Income Tax of Randall Foundation, Inc.") is attached to the complaint as Exhibit C, but each and every allegation and conclusion contained therein is specifically denied.

VI.

Defendant denies the allegations contained in paragraph VI of plaintiff's complaint, except it is admitted that on June 12, 1953, plaintiff filed with defendant a claim for refund for its fiscal year ending April 30, 1952; it is also admitted that a copy of said claim (exclusive of four pages headed "Statement Attached to Claim for Refund of In-

come Tax of Randall Foundation, Inc.") is attached to the complaint as Exhibit D, but each and every allegation and conclusion contained therein is specifically denied.

VII.

Defendant is without knowledge or information sufficient to form a belief as to the truth of the matters alleged in and under "Statement Attached to Claim for Refund of Income Tax of Randall Foundation, Inc.," but defendant admits that said claim for refund contained the identical statements set forth in subsections [39] 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11 and 12 of paragraph VII of plaintiff's complaint.

VIII.

Denies each and every allegation contained in paragraph VIII.

IX.

Defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph IX of plaintiff's complaint, except it is admitted that attached to the complaint as Exhibits E and F are schedules containing sales of securities or property by plaintiff during its fiscal years ending April 30, 1951, and April 30, 1952, respectively.

X.

Defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph X of plaintiff's complaint.

XI.

Defendant admits the allegations contained in paragraph XI of plaintiff's complaint.

XII.

Defendant admits the allegations contained in paragraph XII of plaintiff's complaint.

Wherefore, having fully answered, defendant prays that he be hence dismissed with his costs in this behalf expended.

LAUGHLIN E. WATERS,
United States Attorney;

EDWARD R. McHALE,
Assistant U. S. Attorney,
Chief, Tax Division;

/s/ EDWARD R. McHALE,
Attorneys for Defendant.

Affidavit of Service by Mail Attached.

[Endorsed]: Filed April 21, 1954. [40]

[Title of District Court and Cause.]

STIPULATION OF FACTS

It Is Hereby Stipulated by and between the parties hereto that, in addition to the allegations in plaintiff's complaint which have not been controverted by defendant's answer, the following facts

are true and correct. The relevancy or materiality of said facts is not stipulated.

I.

Plaintiff is, and at all times herein mentioned has been, a California corporation, with its principal place of business in Los Angeles County, California. It was formed on or about May 11, 1950. A true and correct copy of its Articles of Incorporation filed with the California Secretary of State at the time of its organization is attached to the complaint on file herein as Exhibit "A." A true and correct copy of a Certificate of Amendment to said Articles filed with the California Secretary of State on October 9, 1952, is attached [42] to the complaint herein as Exhibit "B." There have been no other amendments to its Articles of Incorporation, and the Articles as thus amended are presently in effect.

II.

Plaintiff adopted a fiscal year ended April 30th, and shortly after the close of its first fiscal year ended April 30, 1951, it filed with the Internal Revenue Service an application for exemption from Federal income tax under Section 101(6) of the Internal Revenue Code. Said application was rejected by the said Service on September 12, 1951. Thereafter, plaintiff through its various tax advisers attempted to convince the Service that it was entitled to such tax exemption but its efforts were unsuccessful, and the Service later denied plaintiff's application for exemption under Section 101(6) for its

fiscal year ended April 30, 1952. In May, 1953, plaintiff employed the Los Angeles law firm of Gibson, Dunn & Crutcher to assist in its efforts to obtain exemption from Federal income taxes. At that time, plaintiff was faced with a demand of the Director of Internal Revenue of Los Angeles to file corporate income tax returns for its fiscal years ending April 30, 1951, and April 30, 1952, and upon advice of said law firm, plaintiff filed with said Director on June 10, 1953, income tax returns for said years computing a tax due for the year ended April 30, 1951, of $6,677.13, and for the year ended April 30, 1952, of $14,113.24. The amounts of tax shown due per said returns were paid to said Director on or about June 10, 1953.

III.

The Director of Internal Revenue at Los Angeles demanded payment of additional tax for the year ended April 30, 1951, in the amount of $14.32, plus penalty for unreasonable delay in filing said return of $1,672.86, plus interest of $497.05. Plaintiff paid these sums on August 21, 1953. The Director of Internal Revenue at Los Angeles demanded payment of additional tax for the year ended April 30, 1952, in the amount of $26.28, plus penalty for unreasonable delay in [43] filing said return of $3,534.88, plus interest of $767.35. Plaintiff paid these sums on August 21, 1953.

IV.

Under date of June 12, 1953, plaintiff filed with

the Director of Internal Revenue at Los Angeles a claim for refund of tax originally paid for its fiscal year ended April 30, 1951, a true and correct photostatic copy of which (exclusive of four pages thereof appearing thereon under the heading "Statement Attached to Claim for Refund of Income Tax of Randall Foundation, Inc.," which pages are pleaded in the complaint herein in haec verba) is attached to said complaint and marked Exhibit "C."

V.

Under date of June 12, 1953, plaintiff filed with defendant a claim for refund of the tax paid pursuant to its return for the year ended April 30, 1952, a true and correct photostatic copy of which (exclusive of four pages thereof appearing under the heading "Statement Attached to Claim for Refund of Income Tax of Randall Foundation, Inc.," and exclusive of five pages thereof appearing under the heading "Memorandum in Support of Taxpayer's Position" which is identical with the statement under said heading appearing as a part of Exhibit "C" to plaintiff's complaint herein) is attached to said complaint and marked Exhibit "D."

VI.

Between the time of the organization of plaintiff and April 30, 1952, gifts of the following property were made by Paul M. Randall to plaintiff on the following dates:

Date	Type of Property	Approximate Market Value at Date of Gift
6/12/50	200 shs.—Reserve Oil & Gas	$ 3,574.26
7/10/50	250 shs.—Toledo Edison	2,492.95
12/ 5/50	100 shs.—Fullerton Oil	3,099.94
12/13/50	100 shs.—Signal Oil & Gas Co.	6,092.44
1/30/51	200 shs.—General Exploration	2,034.90
2/13/51	100 shs.—General Exploration	1,291.70
4/19/51	7000 shs.—Nordon Corp.	1,916.43
4/26/51	1000 shs.—Nordon Corp.	249.49
4/30/52	¼ sh. —Hancock Oil Co.	54.50
4/30/52	3000 shs.—Nordon Corp.	618.47
	Total	$ 21,425.08

VII.

Between the dates of June 13, 1950, and April 9, 1951, Paul M. Randall made loans to the plaintiff Foundation totaling $155,200.00. The date of each loan and the amount thereof are as follows:

Date	Amount
6/13/50	$ 40,000.00
1/ 8/51	14,000.00
1/12/51	7,000.00
1/17/51	12,500.00
3/14/51	1,900.00
3/27/51	7,800.00
4/ 5/51	2,800.00
4/ 9/51	60,000.00
4/ 5/51	9,200.00
Total	$155,200.00

These loans were repaid by payments from the plaintiff Foundation to Paul M. Randall as follows:

Date	Amount
5/29/51	$ 40,000.00
12/27/51	30,000.00
2/ 4/52	85,200.00
Total	$155,200.00

On the latter date, the plaintiff Foundation also paid Mr. Randall $3,617.69 which purported to represent interest at the rate of 2½% per annum on the aforesaid loans. By applying the aforesaid repayments proportionately to the earliest loans and computing interest at 2½% per annum on outstanding balances, using a 30-day month, the total interest at 2½% per annum would have been $3,458.51. The books of the plaintiff Foundation, as examined for all periods prior to April 30, 1953, do not reflect any loans from Paul M. Randall to the plaintiff Foundation other than those set forth above, except that between the date of November 8, 1950, and January 12, 1951, said books reflect that Paul M. Randall loaned to said Foundation a total of 1150 shares of the capital stock of Universal Consolidated Oil Company, and said books reflect no interest or other charge made by Paul M. Randall for such loan.

VIII.

At the time of the aforesaid loans, Paul M. Randall was indebted on margin accounts of fluctuating amounts to the brokerage houses of Akin-Lambert Co., Inc., and Harbison & Henderson Company. The interest which Paul Randall personally was charged on said indebtedness depended on two factors:

(i) The prime effective rate of interest; and

(ii) The amount of his borrowings upon said accounts.

The interest rate charged by said brokerage houses to Paul Randall personally on said indebt-

edness during the months from May, 1950, through December, 1951, and the amount of interest so charged were as follows:

Month	Akin-Lambert Co., Inc.		Harbison & Henderson Co.	
1950	Rate	Amount	Rate	Amount
June	2%	$285.65	2%	$266.18
July	2%	319.24	2%	266.63
August	2%	315.43	2%	261.92
September	2%	297.73	2%	234.54
October	2¼%	321.97	2½%	317.04
November	2¼%	302.16	2½%	307.70
December	2¼%	281.19	2¼%	241.02
1951				
January	2½%	447.40	2½%	260.57
February	2½%	460.65	2½%	239.00
March	2½%	518.34	2½%	265.20
April	2½%	428.05	2½%	256.49
May	2½ & 3%	388.68	3%	260.15
June	3%	372.02	3½%	117.66
July	3%	448.11	3%	120.61
August	3%	505.41	3%	129.49
September	3%	499.14	3%	125.00
October	3%	552.54	3%	125.94
November	3%	413.56	3% (10 days' Int.)	50.00
December	3%	440.25		

The $40,000 loaned by Paul M. Randall to the plaintiff Foundation on June 13, 1950, was borrowed at the same time by him on the aforesaid Akin-Lambert margin account, but since some of said loans were made by check on Paul Randall's personal account, it is not possible to determine the exact source of each loan to the Foundation.

IX.

During the period of time between the formation of plaintiff Foundation and April 30, 1952, it made

the following gifts to various charitable or non-profit educational organizations on the following dates: [47]

Date	Organization	Amount
4/24/51	Children's Hospital Society of L.A.	$ 500.00
5/26/51	Sister Elizabeth Kenny Foundation	100.00
7/22/51	St. John's Hospital	1,000.00
8/31/51	Montecito School for Girls	2,000.00
4/30/52	David Seabury School of Psychology	2,000.00
4/30/52	Bureau of Welfare, California Teachers' Association	1,000.00
4/30/52	American Red Cross	1,000.00
4/30/52	Y.M.C.A. of South Pasadena	1,000.00
4/30/52	All Nations Foundation	1,000.00
4/30/52	Children's Hospital of Los Angeles	500.00
4/30/52	Montecito Schools, Inc.	500.00
4/30/52	Girl Scouts of South Pasadena	100.00
4/30/52	Cate School	1,000.00
	Total	$ 11,700.00

X.

Schedule F attached to plaintiff's complaint herein is a correct schedule containing all sales of securities or property by plaintiff during the fiscal year ended April 30, 1952, and Schedule E attached to plaintiff's complaint herein is a correct schedule containing all sales of securities or property by plaintiff during its fiscal year ended April 30, 1951.

XI.

The income, expenses, and gains from disposition and sale of securities of plaintiff for its three fiscal years ended April 30, 1951; April 30, 1952, and April 30, 1953, were as follows:

	Year Ended		
	4/30/51	4/30/52	4/30/53
Dividends and interest	$10,285.00	$ 7,081.93	$ 2,937.67
Expenses	1,532.36	8,271.99	5,966.03
Gains from disposition and sale of securities	30,238.27	51,079.61	5,456.01

XII.

In response to the aforesaid application for exemption for the fiscal year ended April 30, 1951, the Commissioner of Internal Revenue in Washington ruled on September 12, 1951, that the plaintiff Foundation was not entitled to an exemption. The basis of said ruling is contained in the following paragraph thereof:

"It is the opinion of this office that the income received by you has not been devoted to the purposes for which you were incorporated in such a manner and to such an extent as to constitute operations for such purposes within the meaning of section 101(6) of the Code. Furthermore, your activities are primarily those of an organization engaged in the ordinary business of buying and selling securities. An organization which is operated for the primary purpose of carrying on a trade or business for profit is not exempt from Federal income tax notwithstanding all of its profits are payable to organizations or purposes specified in section 101(6) of the Internal Revenue Code."

XIII.

Subsequent to said rejection of its claim under Section 101(6), the plaintiff Foundation filed sev-

eral requests for reconsideration, involving both the facts prior to the amendment of the Articles referred to in Paragraph I of this stipulation and the amendment to the Bylaws set forth hereinafter, and the facts subsequent to said amendments. In rulings dated January 15, 1952, June 16, 1952, and January 8, 1953, the Bureau adhered to its original ruling, and in each instance concluded that the plaintiff Foundation [49] was not exempt. The basis of the ruling of January 8, 1953, is contained in the following paragraph thereof:

"A review has been made of the evidence which formed the basis of Bureau rulings of September 12, 1951; January 15, 1952, and June 16, 1952, in connection with the information subsequently submitted and the statements made at conferences held with representatives of this office in connection with this matter. It is believed on the basis of the facts and evidence submitted, that your activities have been primarily those of an organization engaged in the ordinary business of buying and selling securities, and that there is no error in the conclusion reached in Bureau rulings of September 12, 1951; January 15, 1952, and June 16, 1952, and they are, therefore, hereby affirmed."

XIV.

Pages 10 through 18 of this Stipulation contain a true and correct copy of the Bylaws of plaintiff Foundation and the amendment to said Bylaws of September 30, 1952. There have been no other

amendments to said Bylaws and said Bylaws as thus amended are presently in effect.

XV.

Pages 19 through 57 of this Stipulation contain in chronological order a true copy of all Minutes and all other documents or papers contained in the Minute Book of plaintiff Foundation, except the Articles, amended Articles, Bylaws, and amended Bylaws.

Dated this 27th day of September, 1954.

GIBSON, DUNN & CRUTCHER,
BERT A. LEWIS,

By /s/ BERT A. LEWIS,
Attorneys for Plaintiff.

LAUGHLIN E. WATERS,
United States Attorney;

EDWARD R. McHALE,
Assistant U. S. Attorney,
Chief, Tax Division;

/s/ EDWARD R. McHALE,
Attorneys for Defendant. [50]

Bylaws of Randall Foundation, Inc.

Randall Foundation, Inc., is a non-profit corporation organized pursuant to the non-profit corporations law of the State of California, and particularly Part I of Division 2 of Title I of the Corporations Code.

Article I.

Corporate Powers:

The corporate powers of this corporation shall be vested primarily in a board of five trustees, a majority of whom shall constitute a quorum for the purpose of transacting all business.

Article II.

Term of Office and Election of Trustees:

The Trustees named in the Articles of Incorporation shall act as Trustees for the following periods, respectively, and until the election or qualification of their successors, to wit:

Paul Randall	For life
Frank R. Randall	2 years
Dorothy R. Ward	1 year
Frederick W. Bailes	1 year
James A. Flanagan	1 year

Upon the expiration of the term of any Trustee or upon any vacancy occurring in the Board of Trustees or upon any change in the number of the Board requiring additional members, the then remaining members of the Board of Trustees either at a special meeting called for such purpose or at their next regular meeting, shall elect the Trustee or Trustees necessary to complete the Board, and shall thereupon fix, by resolution, the term for which such Trustee or Trustees shall serve. [51]

Article III.

Powers of Trustees:

The Board of Trustees shall have power:

(1) To appoint and remove officers, agents and employees of the corporation, prescribe their duties, and fix the compensation and term of office or service.

(2) To conduct, manage and control the business affairs and property of the corporation, and to make rules and regulations for the guidance of the corporation's officers and management of business affairs of the corporation.

(3) To incur indebtedness for purposes of the corporation, the terms and amounts of such indebtedness to be entered upon the usual books of the corporation; to invest the funds of the corporation for the purpose of building up reserves for foundation purposes; to determine the charities, educational institutions, or religious institutions which may from time to time be the beneficiary of the Foundation's gifts.

(4) To perform all other duties and exercise all other powers permitted by law to be done or exercised by the Trustees or members of a non-profit organization organized under Part I of Division 2 of Title I of the Corporations Code of the State of California.

Article IV.

Officers and Their Duties:

The Board of Trustees of the corporation shall elect a President, a Vice President, a Secretary and a Treasurer.

The President of the Board of Trustees shall preside over all meetings of the Board. He shall sign as President all contracts and other instruments of writing which have been first approved or authorized by the Board of Trustees, unless some other officer is [52] designated in the resolution. He may call the Trustees together whenever he deems it necessary. If at any time the President shall be unable to act, the Vice President shall take his place and perform his duties, and if for any reason the Vice President shall be unable to act, the Board of Trustees shall appoint some other member of the Board to act, in whom shall be vested, for the time being, all of the duties and functions of the office. The President shall perform all duties and acts ordinarily performed by the head of a non-profit foundation and to the extent authorized by law and by resolution of the Board of Trustees.

Vice President:

The Vice President shall act in place and in stead of the President whenever the latter is unable to act and perform such other duties as may from time to time be prescribed by the Board of Trustees.

Secretary:

The Secretary shall keep a record of the acts and proceedings of the Board of Trustees. He shall keep the corporate seal of the corporation, sign and affix the seal of the corporation to all contracts, certificates and other papers authorized to be executed by the Board of Trustees. He shall serve notices required, either by law or by the Bylaws of the corporation, and in the event of failure to do so, then such notices may be served by any person thereunto authorized by the President or by the Board of Trustees.

Treasurer:

The Treasurer shall receive and keep all of the funds of the corporation, and pay them out only in accordance with the procedure adopted and approved by the Board of Trustees. He shall promptly deposit all moneys or credits of the corporation in a bank or banks to be selected by the Board of Trustees; record the date, amount and description of each item thereof; and, as Treasurer, when and as required by the Board of Trustees, will execute a good and sufficient bond to protect the interests of the corporation. [53]

Article V.

Bylaws may be adopted, amended, altered or repealed at any regular meeting of the Trustees by the affirmative vote of a majority of the trustees then in office, or by the written assent of a majority of the Trustees then in office.

Article VI.

Meetings of Trustees:

Regular meetings of the Trustees of the corporation shall be held on the last Monday of each month, beginning with the last Monday of the month of July, 1950. Such meetings shall be without notice. Special meetings shall be held on call of the President by personal notice to each Trustee at least twenty-four hours before such meeting, or by mail, postage prepaid, and such notice mailed to each Trustee at least forty-eight hours before such meeting at his last known address, as shown by the records of the corporation. Special meetings may be held at any place or time when all of the Trustees are present and the minutes of the meeting show the consent to hold such meetings.

Article VII.

Upon dissolution or winding up of the corporation, after paying or adequately providing for the debts and obligations of the corporation, any remaining assets shall be distributed to a tax exempt religious, educational or charitable organization located in California and selected by the Board of Trustees.

Know All Men by These Presents:

That we, the undersigned, being all of the persons appointed in the Articles of Incorporation to act as the first Board of Directors of Randall Foundation, Inc., hereby assent to the foregoing Bylaws

and adopt the same as the Bylaws of this corporation. [54]

In Witness Whereof, we have set our hands and seals this 21st day of May, 1950.

/s/ PAUL M. RANDALL,

/s/ FRANK R. RANDALL,

/s/ DOROTHY R. WARD,

/s/ JAMES A. FLANAGAN,

/s/ FREDERICK W. BAILES. [55]

This Is to Certify that I am the duly elected, qualified and acting Secretary of Randall Foundation, Inc., and that the above and foregoing Bylaws were adopted as the Bylaws of said corporation on the 21st day of May, 1950, by the persons appointed in the Articles of Incorporation to act as the first Trustees of said corporation.

In Witness Whereof, I have hereunto set my hand this 21st day of May, 1950.

/s/ DOROTHY R. WARD,
Secretary. [56]

Amendments to Bylaws of
Randall Foundation, Inc.

Resolved that the bylaws of Randall Foundation, Inc., be and the same are hereby amended in the following respects, to wit:

One: Subparagraphs (3) and (4) of Article III of the bylaws are hereby amended to read as follows:

(3) To incur indebtedness for purposes of the corporation, the terms and amounts of such indebtedness to be entered upon the usual books of the corporation; to invest the funds of the corporation for the purpose of building up a fund for the erection and maintenance of the home described in Article II of the Amended Articles of Incorporation of this corporation.

(4) To perform all other duties and exercise all other powers permitted by law to be done or exercised by the trustees or members of a non-profit organization organized under Part I of Division 2 of Title I of the Corporation Code of the State of California, and permitted by Section 101 (6) of the United States Internal Revenue Code.

Two: Article VII of the bylaws as it now reads is deleted and said Article VII shall read as follows:

VII.

No member shall have any proprietary interest whatever in or to any of the assets of the corporation, and no income, increment, or other pecuniary gain, benefit or advantage of any kind, in any way arising from or growing out of the assets of the corporation or their operation will inure to or in any way go to or vest in any member of the corporation.

Three: There shall be added to the bylaws an

Article VIII, which said Article VIII shall read as follows: [57]

VIII.

It is intended that in accomplishing the primary purpose of the corporation as set forth in Article II of the articles of incorporation, construction of the home described in said Article II be commenced by December 31, 1957, or that the corporation establish facilities for the actual residence of at least 50 inmates not later than December 31, 1959.

If the corporation fails in the accomplishment of the primary purpose set forth in Article II of the articles of incorporation, then the trustees shall consider appropriate resolutions for dissolution of the corporation after paying or adequately providing for the debts and obligations of the corporation. Any remaining assets shall be distributed to such religious, educational or charitable organizations as may be selected by the Board of Trustees; however, the Board of Trustees may designate only such organizations as are located in the State of California and which qualify as exempt organizations under the provisions of Section 101 (6) of the United States Internal Revenue Code.

In the event that the corporation shall be dissolved in accordance with the provisions of this Article VIII, the trustees shall make distribution to exempt organizations within 12 months of the date of the resolution dissolving the corporation.

Resolved Further that a complete copy of the bylaws as amended be now made and attached to

these Minutes and that said bylaws as amended be made a part of the books and records of this corporation.

There being no further business to come before the meeting, the meeting was upon motion duly made and seconded, and vote being taken, adjourned.

/s/ DOROTHY R. WARD,
Secretary.

Approved:

/s/ PAUL M. RANDALL,
President. [58]

This is to certify that I am the duly elected, qualified and acting secretary of Randall Foundation, Inc., and that a regular meeting of the Board of Trustees of Randall Foundation, Inc., was duly and regularly held on the last Monday in September, to wit, September 29, 1952, at the hour of 2:15 p.m., at the principal office of the corporation, in accordance with the provisions of the bylaws of the corporation with respect to such regular meeting, and that at said meeting there were at all times present and acting a quorum of the Board of Trustees, to wit, four of the five trustees of said corporation, and that the within Minutes to which this certification is attached are the Minutes of said regular meeting so held, and that at said meeting the resolutions set forth in the within Minutes, including the resolutions specifically amending the articles of incorporation and amending the bylaws of the corporation, were duly and regularly passed.

In Witness Whereof I have hereunto set my hand this 30th day of September, 1952.

/s/ DOROTHY R. WARD,
Secretary. [59]

Waiver of Notice and Consent to Holding of First Meeting of Incorporators and Directors of Randall Foundation, Inc., a California Corporation

We, the undersigned, being all of the incorporators and directors named in the Articles of Incorporation of Randall Foundation, Inc., a non-profit California Corporation duly formed by the filing of said Articles of Incorporation in the office of the California Secretary of State on the 18th day of May, 1950, and desiring to hold the first meeting of the Incorporators and Directors of said corporation for the purpose of completing the organization of its affairs, Do Hereby Waive Notice of said meeting, and Consent to the holding thereof at 2050 Fremont, South Pasadena, California, in the City of South Pasadena, County of Los Angeles, State of California, on the 21st day of May, 1950, at 2:00 o'clock in the afternoon of said day, for the purpose of adopting bylaws, electing officers, adopting a form of corporate seal, and transacting such other business as may be brought before said meeting; and do hereby further agree that any business transacted at said meeting shall be as valid and legal and of the same force and effect as though said meeting were held after notice duly given.

Witness our signatures this 21st day of May, 1950.

/s/ PAUL M. RANDALL,

.....

/s/ FRANK R. RANDALL,

.....

/s/ DOROTHY R. WARD,

.....

/s/ JAMES A. FLANAGAN,

.....

/s/ FREDERICK W. BAILES, [60]

.....

Minutes of First Meeting of Incorporators and Directors of Randall Foundation, Inc., a California Corporation

The incorporators and directors named in the Articles of Incorporation of Randall Foundation, Inc., a non-profit California Corporation, and constituting the Board of Directors of said corporation, held their first meeting at 2050 Fremont in the City of South Pasadena, County of Los Angeles, State of California, on the 21st day of May, 1950, at 2:00 o'clock in the afternoon of said day.

Present at said meeting were all of the incorporators and Directors of said corporation named in its Articles of Incorporation.

On motion and by unanimous vote, Mr. Paul Randall was elected temporary Chairman and Mrs. Dorothy R. Ward was elected temporary secretary of the meeting.

The Chairman announced that the meeting was held pursuant to written waiver of notice thereof and consent thereto signed by all of the incorporators and directors of the corporation named as such in the Articles of Incorporation; such waiver and consent was presented to the meeting, and upon motion made and unanimously carried, was made a part of the records of the meeting, and now precedes the minutes of this meeting in the book of minutes of the corporation.

The Chairman stated that the original Articles of Incorporation of the corporation had been filed in the office of the California Secretary of State on the 18th day of May, 1950, and that a copy thereof, certified by said Secretary of State, had been filed in the office of the County Clerk of Los Angeles County, on the 23rd day of May, 1950, being the County in which the corporation is to have its principal office; he presented to the meeting a certified copy of said Articles of Incorporation, and the secretary was directed to insert said copy in the Book of Minutes of the corporation. [61]

The matter of the adoption of Bylaws for the regulation of the affairs of the corporation was next considered. The secretary presented to the meeting a form of bylaws, which were duly considered and discussed. On motion duly made and unanimously carried, the following resolutions were adopted, to wit:

Resolved, That the bylaws presented to this meeting and discussed thereat be, and the same hereby

are, adopted as and for the bylaws of this corporation.

Resolved Further, That the secretary of this corporation be, and he hereby is, authorized and directed to execute a certificate of the adoption of said bylaws and to insert said bylaws as so certified in the Book of Minutes of this corporation, and to see that a copy of said bylaws, similarly certified, is kept at the principal office for the transaction of business of this corporation, in accordance with Section 302 of the California Civil Code.

The meeting then proceeded to the election of officers. The following were duly elected to the offices indicated after the names of each:

1. President: Mr. Paul Randall.
2. Vice-President:
3. Secretary: Dorothy R. Ward.
4. Treasurer: Dorothy R. Ward.

Each officer so elected being present accepted his or her office, and, thereafter, the president presided at the meeting as Chairman, and the secretary acted as secretary of the meeting.

The secretary presented for approval of the meeting a proposed seal of the corporation, consisting of two concentric circles with the words "Randall Foundation, Inc., California," and the words and figures "Incorporated May 18, 1950," in the form and figure as follows: [62]

(Seal) (Seal)

On motion duly made and unanimously carried, the following resolution was adopted:

Resolved, That the corporate seal, in the form, words and figures presented to this meeting, be, and the same hereby is, adopted as the seal of this corporation.

In order to provide for the payment of expenses of incorporation and organization of the corporation, on motion duly made and unanimously carried, the following resolution was adopted:

Resolved, That the president or vice-president and the treasurer of this corporation be, and they hereby are, authorized and directed to pay the expenses of the incorporation and organization of this corporation.

After some discussion, the location of the principal office of the corporation in Los Angeles County, California, the county named in the Articles of Incorporation as that in which the principal office for the transaction of the business of the corporation is to be located, was fixed pursuant to the following resolution, adopted, on motion duly made and unanimously carried:

Resolved, That 2050 Fremont Avenue, City of South Pasadena, California, be, and the same hereby is, designated and fixed as the principal office for the transaction of the business of this corporation in the County of Los Angeles, State of California.

To provide for a depository for the funds of the corporation, and to authorize certain officers to deal

with the corporate funds, the following resolution was adopted:

Resolved, That the funds of this corporation be deposited with Citizens National Trust & Savings Bank of Los Angeles County, California, main branch.

Resolved Further, That all checks, drafts and other instruments obligating this corporation to pay money, shall be signed by the President of this corporation, Paul Randall. [63]

The attorney for the corporation, to wit: James A. Flanagan, who has been serving temporarily as a director, then tendered his resignation to the Board, and upon motion duly made and seconded, and vote being taken, said resignation was accepted. The written resignation of Director James A. Flanagan was then ordered attached to the minutes of the meeting.

There being no further business to come before the meeting, upon motion, duly made, seconded and unanimously carried, the Meeting Adjourned.

/s/ PAUL RANDALL,
Temporary Secretary;

/s/ DOROTHY R. WARD,
Secretary.

Attest:

/s/ PAUL M. RANDALL,
Temporary Chairman;

/s/ PAUL RANDALL,
President and Chairman. [64]

June, 1950.

To the Board of Directors,
Randall Foundation, Inc.:

I hereby tender my resignation as a member of the Board of Directors of the corporation, to become effective as of the close of the first meeting of the Board.

/s/ JAMES A. FLANAGAN. [65]

Special Meeting of the Board of Trustees
of Randall Foundation, Inc.

Held May 22, 1950, at the Principal Office
At 2:00 o'Clock P.M.

The meeting was called to order by the President, Paul Randall, and upon the roll being called all of the then Trustees were found to be present.

The Chairman stated that the purpose of the meeting was to discuss the opening of a trading account in the name of the Foundation, with Aiken-Lambert Company, brokerage firm in Los Angeles, California, and upon motion being made and seconded and vote being taken, the following resolution was duly passed:

Whereas, this Corporation has received by way of loan and gift certain moneys and securities (all of same to date from Paul Randall, President of the Corporation); and

Whereas, it is deemed by the Corporation advisable, in order to build a fund to carry out the purposes of the Corporation, to authorize Paul Randall, President of the Corporation, to invest the funds of the Corporation advanced to it by the said Paul Randall, and to that end the Corporation desires to empower the said Paul Randall to act for the Corporation in dealing with securities and with the funds of the Corporation, and to open a trading account, or accounts, in the name of the Corporation, and buy and sell therein on behalf of the Corporation;

Now, Therefore, Be It Resolved: That Paul Randall, President of this Corporation, be and he hereby is, authorized and empowered for and on behalf of this Corporation, to establish and maintain one or more [66] accounts, which may be marginal accounts, with:

Aiken-Lambert Company

in the City of Los Angeles, State of California, for the purpose of purchasing, investing in, or otherwise acquiring, selling (including short-sales), transferring, exchanging or otherwise disposing of, and generally dealing in and with various forms of securities, including shares, stocks, bonds, rights to subscribe, option warrants, and certificates of interest, secured or unsecured.

Further that the fullest authority at all times with respect to such commitment, or with respect to any transaction deemed by the President, Paul

Randall, to be proper in connection therewith, is hereby conferred, including authority to give written or oral instructions to the Brokers with respect to said transaction, the only limitation on the authority herein given being that said Paul Randall, President, shall limit his stock purchases to that amount available from time to time by way of cash or securities in the treasury of the Corporation, said amount now being in the sum of $40,000.00 cash, and ..... shares of ..... stock; though, as aforesaid, he may purchase on margin to the extent that the available assets of the Corporation permit.

The said President, Paul Randall, is further authorized to pay in cash or by checks and/or drafts drawn upon the funds of the corporation, such sums as may be necessary in connection with any of said accounts; to endorse any securities in order to pass title thereto; to direct the sale or exercise of any rights with respect to any securities; to accept delivery of any securities, and generally to do and take all action necessary in connection with said account or accounts. [67]

Be It Further Resolved, that the Brokers named herein may deal with Paul Randall, President, so empowered by the foregoing resolution, as though they were dealing with the Corporation itself.

Be It Further Resolved, that the said Brokers may rely upon the aforesaid resolution as continuing fully effective until the Brokers shall receive

due written notice of a change in, or the rescission of the authority so evidenced.

There being no further business to come before the meeting, on motion duly made and seconded, it was adjourned.

The signature of Paul Randall herein below shall constitute his approval of the understanding herein set forth.

/s/ DOROTHY R. WARD,
Secretary.

/s/ PAUL RANDALL. [68]

Special Meeting of the Board of Trustees
of Randall Foundation, Inc.

Held June 16, 1950, at the Principal Office
At 2:00 o'Clock P.M.

The meeting was called to order by the President, Paul M. Randall, and upon the roll being called, all of the then Trustees were found to be present.

The Chairman stated that the purpose of the meeting was to acknowledge a loan from Paul M. Randall to the Foundation in the amount of $40,000.00 and to issue a note therefor pursuant to the previous understanding of the Trustees with relation to this loan and other loans to follow.

Upon motion duly made, seconded and vote being taken, the following resolution was duly passed:

Resolved, That Whereas, this Foundation hopes to acquire assets for the Foundation purposes through the investment of funds secured by way of loan or gift from Paul M. Randall primarily; and

Whereas, by reason of the premises this corporation received certain shares of Reserve Oil and Gas Company stock from Paul M. Randall by way of Gift on June 12, 1950, and a loan of $40,000.00 on June 13, 1950, which latter sum was credited to the account of the Foundation with Akin Lambert Co., Inc., brokerage firm, Los Angeles, California; and

Whereas, it was theretofore agreed and understood that in each instance where a loan is made to the Foundation the Foundation would issue its note payable on demand at any time after .... days from date, with interest at 2½% payable at maturity; [69]

Now, Therefore, pursuant to such agreement and understanding, and for the purpose of carrying out the contemplated plan of the Foundation to acquire funds for investment in order to build up its treasury with assets to be applied to the purposes of the Foundation, the Foundation hereby acknowledges receipt by way of loan from Paul M. Randall of the sum of $40,000.00 cash and the Secretary of the Foundation is hereby authorized and directed to execute and deliver to Paul M. Randall a promissory note of the Foundation, payable on demand at any time after .... days from date in the amount of $40,000.00, bearing interest at 2½% per annum, payable at maturity.

There being no further business to come before the meeting, on motion duly made and seconded, it was adjourned.

/s/ DOROTHY R. WARD,
Secretary.

Approved:

/s/ PAUL RANDALL,
President. [70]

Special Meeting of the Board of Trustees of Randall Foundation, Inc.

Held October 16, 1950, at the Principal Office At 2:00 o'Clock P.M.

The meeting was called to order by the President, Paul Randall, and upon the roll being called, all of the Trustees were found to be present.

Mr. Randall stated to the meeting that the purpose thereof was to open additional trading accounts, similar to the one opened by the corporation in May, 1950, and authorizing him to invest funds of the corporation in the market with a view to building a reserve capable of carrying out the educational, charitable and other purposes of the Foundation.

After discussion had the following resolutions were, upon vote being taken, duly and regularly passed:

Whereas, this Corporation has received by way of loan and gift certain moneys and securities (all

of same to date from Paul Randall, President of the Corporation); and

Whereas, it is deemed by the Corporation advisable, in order to build a fund to carry out the purposes of the Corporation, to authorize Paul Randall, President of the Corporation, to invest the funds of the Corporation advanced to it by the said Paul Randall, and to that end the Corporation desires to empower the said Paul Randall to act for the Corporation in dealing with securities and with the funds of the Corporation, and to open a trading account, or accounts, in the name of the Corporation, and buy and sell therein on behalf of the Corporation;

Now, Therefore, Be It Resolved: That Paul Randall, President of this Corporation, be [71] and he hereby is authorized and empowered, for and on behalf of this Corporation, to establish and maintain one or more accounts, which may be marginal accounts, with:

Harbison & Henderson, Brokers;
E. F. Hutton & Co., Brokers;
Dean Witter & Co., Brokers;

all in the City of Los Angeles, State of California, for the purpose of purchasing, investing in, or otherwise acquiring, selling (including short-sales), transferring, exchanging, or otherwise disposing of, and generally dealing in and with various forms of securities, including shares, stocks, bonds, rights to subscribe, option warrants, and certificates of interest, secured or unsecured. Further, that the

fullest authority at all times with respect to such commitment, or with respect to any transaction deemed by the President, Paul Randall, to be proper in connection therewith, is hereby conferred, including authority to give written or oral instructions to the Brokers with respect to said transaction, the only limitation on the authority herein given being that said Paul Randall, President, shall limit his stock purchases to that amount available from time to time by way of cash or securities in the treasury of the Corporation, said amount now being in the sum of $40,000.00 cash, and shares of Reserve Oil and Gas stock; though, as aforesaid, he may purchase on margin to the extent that the available assets of the Corporation permit.

The said President, Paul Randall, is further authorized to pay in cash or by checks and/or drafts drawn upon the funds of the corporation, such sums as may be necessary in connection with any of said accounts; to endorse any securities in order to pass title thereto; to direct the sale or [72] exercise of any rights with respect to any securities; to accept delivery of any securities, and generally to do and take all action necessary in connection with said account or accounts.

Be It Further Resolved, that the Brokers named herein may deal with Paul Randall, President, so empowered by the foregoing resolution, as though they were dealing with the Corporation itself.

Be It Further Resolved, that the said Brokers may rely upon the aforesaid resolution as continuing

fully effective until the Brokers shall receive due written notice of a change in, or the rescission of the authority so evidenced.

There being no further business to come before the meeting, on motion duly made and seconded, it was adjourned.

/s/ DOROTHY R. WARD,
Secretary. [73]

Special Meeting of the Board of Trustees
of Randall Foundation, Inc.

Held January 8, 1951, at the Principal Office
At 2:00 o'Clock P.M.

The meeting was called to order by the President, Paul M. Randall, and upon roll being called all of the then Trustees were found to be present.

The Chairman stated that the purpose of the meeting was to discuss further borrowings of the Foundation and authorizing the execution of notes for loans made.

On Motion duly made, seconded and vote being taken, the following Resolution was duly passed:

Resolved, That Whereas, it has been the adopted policy of this Foundation to build its asset position through investments made with loans and gifts to the Foundation; and whereas, it has been the further policy of this Foundation to issue its demand note for loans made with interest at 2½% payable at maturity; and

Whereas, Paul M. Randall, the President of the Foundation, has heretofore loaned money to the Foundation, and has been willing to accept the Foundation demand note therefor; and

Whereas, it now appears advisable that this Foundation borrow from time to time additional moneys from Paul M. Randall, as he may be willing to loan same and to invest those moneys in shares of stock, which in the opinion of Paul M. Randall and the Board of Trustees will likely enhance in value to the profit of the Foundation,

Now, Therefore, be it resolved that by reason of the premises this Foundation borrow for the purposes above outlined such additional funds from Paul M. Randall from time [74] to time as he may be willing to loan upon the demand note of the Foundation at 2½% interest, and the Secretary of this Foundation is hereby authorized and directed to issue on behalf of the Foundation from time to time and execute and deliver the note of the Foundation to Paul M. Randall for such sum or sums as he may loan to the Corporation, the note or notes so executed and delivered to be in exchange for cash or its equivalent and to be payable on demand at any time after .... days, and to bear interest at 2½% payable at maturity.

Resolved, Further, that so long as Paul M. Randall is willing to loan money to the Foundation as aforesaid, upon the basis aforesaid, and looking only to the assets of the Foundation for repayment, no limit upon the borrowing for the purposes aforesaid

shall be fixed, but this arrangement, of course, may be changed from time to time by the Board of Trustees.

Some discussion was had about making a gift at this time to Children's Hospital Society of Los Angeles, and upon motion duly made, seconded, and carried, it was

Resolved, that Paul M. Randall of this Foundation be authorized to give the sum of $500 to the Children's Hospital Society of Los Angeles, a charitable organization;

Be It Further Resolved, that the directors of this Foundation make an effort to seek out worthy causes to receive from time to time the bounty of this Foundation, and particularly give thought to the establishment or backing of some one special organization or institution or the founding thereof, with a view to having this Foundation play a major roll in the development of a special worthy charitable organization. [75]

There being no further business to come before the board, on motion duly made and seconded, the meeting adjourned.

/s/ DOROTHY R. WARD,
Secretary.

Approved:

/s/ PAUL RANDALL,
President. [76]

Special Meeting of the Board of Trustees
of Randall Foundation, Inc.

Held May 15, 1951, at the Principal Office
At 2:00 o'Clock P.M.

That meeting was called to order by the President, Paul M. Randall, and upon the roll being called all of the then Trustees were found to be present.

The President stated that the purpose of the meeting was to examine the annual statement of the Company, approve the matters connected therewith, and upon motion duly made, seconded and vote being taken, the following resolution was unanimously passed:

Resolved, That Whereas, the annual statement of the Foundation prepared by Sidney R. Reed & Co., Tax Counsellors and Auditors, has been exhibited and read to the meeting;

Now, Therefore, Be It Resolved that said statement be and the same is hereby approved as to all particulars, and the Board of Trustees do hereby acknowledge the receipt of the loans from Paul M. Randall in said statement set forth, and do hereby approve the execution and delivery by the Foundation of the Foundation's promissory notes to Paul M. Randall, payable on demand at any time after .... days in the amounts as set forth on Exhibit "C" of the annual statement aforesaid, and bearing interest at 2½% payable at maturity;

Resolved, Further, that the President and/or Secretary of this Foundation be and they are, or either

of them is, hereby authorized to pay to Sidney R. Reed & Co. the amount of the bill submitted for the preparation of such annual statement, for the preparation of tax exemption affidavits and other matters connected therewith. [77]

Be It Further Resolved, that whereas this corporation has received to date in excess of $20,000.00 by way of gifts from Paul M. Randall and loans totalling $155,200.00, by reason of all of which the Foundation has been able to operate at a profit for the year and acquire an earned surplus of $59,-243.02.

Now, Therefore, the Board of Trustees wish to record its appreciation of the help and assistance given by the said Paul M. Randall and to acknowledge that his contributions of time and money are making possible the growth and attainment of the purposes of the Foundation.

Be It Further Resolved, that the donation made by the Foundation to Children's Hospital Society of Los Angeles, as shown in the annual statement be and the same is hereby approved.

Be It Further Resolved, that this Foundation examine additional charitable organizations with a view to making immediate contributions; and further

That the plan of establishing a school or place for boys or of selecting one institution or cause to be backed by the Foundation be further pursued at this time in view of the earnings of the corporation

in order that a substantial part of the funds may be earmarked for such school, institution or cause and the Foundation thereby become the prime mover in the development thereof.

There being no further business to come before the meeting, on motion duly made and seconded, it was adjourned.

/s/ DOROTHY R. WARD,
Secretary.

Approved:

/s/ PAUL RANDALL,
President. [78]

Minutes of Meeting of Board of Trustees
of Randall Foundation, Inc.

Held May 30th, 1951, at the Principal Office
At 2:00 o'Clock P.M.

The meeting was called to order by the President, Paul M. Randall, and, upon the roll being called, all of the Trustees were found to be present.

The president stated that the purpose of the meeting was to pass upon some additional contributions by the Foundation, in view of the fact that the treasury of the Foundation was in good condition to make some immediate distributions, and Mr. Randall was willing, though the Foundation was considerably indebted to him, that such contributions be made.

A discussion followed with respect to making immediate distributions or gifts when the purpose of the Foundation was to build up a sufficient fund to establish some institution wholly or mostly backed by the Randall Foundation, but after such discussion, the following resolution was adopted:

Resolved, that Paul M. Randall, president of this Foundation, be and he is, hereby authorized to make from the treasury of the Foundation, the following gifts to:

Sister Kenny Foundation	$ 100
St. Mary's Hospital, Santa Monica, California	$1,000
Montecito Schools, Inc., Santa Barbara, California	$2,000

Be It Further Resolved that this Foundation make a thorough investigation of the intentions of Montecito Schools, Inc., with respect to founding a school for boys, with a view to making additional contributions to said [79] Montecito Schools for such or related purposes.

There being no further business to come before the meeting, the meeting was thereupon, upon motion duly made, seconded and carried, adjourned.

/s/ DOROTHY WARD,
Secretary.

Approved:

/s/ PAUL RANDALL,
President. [80]

Minutes of Meeting of Board of Directors
of Randall Foundation

Held November 18th, 1951

The meeting was called to order by Paul R. Randall, President, and upon the roll being called, all of the Directors were found to be present.

Paul R. Randall stated to the meeting that it was advisable to fill a vacancy in the Board of Directors caused by the resignation some time ago of James A. Flanagan, and further vacancies which would occur on acceptance of the resignation of Frank Randall, which had been submitted to the meeting.

On nomination being made and seconded and vote being taken, James A. Flanagan was re-elected as a member of the Board of Directors.

The resignation of Frank Randall was then offered to the meeting and upon vote being taken, said resignation was duly accepted.

Thereupon, nominations were opened to fill the vacancy caused by said resignation and upon nomination being made and seconded, the nominations duly closed and vote being duly taken, J. P. Patterson was elected as a member of the Board of Directors.

There being no further business to come before the meeting, the meeting was duly adjourned.

/s/ DOROTHY R. WARD,
Secretary.

Approved:

/s/ PAUL RANDALL. [81]

Minutes of Meeting of Board of Trustees
of Randall Foundation, Inc.

Held March 1st, 1952, at the Principal Office
At 2:00 o'Clock P.M.

The meeting was called to order by the President, Paul M. Randall, and upon roll being called, all of the trustees were found to be present.

The president stated that the purpose of the meeting was to consider and discuss charitable or other contributions to be made by the Foundation, with a view to disposing of, by gift, all of the moneys received by the Foundation by way of dividends and interest since the inception of the Foundation, not heretofore granted or given.

A discussion then followed, whereupon, the following resolution was, upon motion duly made, and seconded, passed:

Resolved: That Paul M. Randall, President of this Foundation be, and he is hereby authorized to make gifts from the treasury of the Foundation in a total amount equal to all of the dividends and interest received by the Foundation during the fiscal year, and such amounts of dividends and interest received by the Foundation prior to this fiscal year as have not heretofore been given away. All such gifts shall be made to all or any of the following tax exempt institutions, and the amount recommended with respect to such gifts in each instance is set forth opposite the name thereof, to wit: [82]

All Nations Foundation	$1,000
American Red Cross	1,000
Bureau of Welfare, California Teachers' Association	1,000
Cate School	1,000
Children's Hospital of Los Angeles	500
David Seabury School of Psychology	2,000
Girl Scouts of South Pasadena	100
Montecito Schools	2,500
St. John's Hospital	1,000
Sister Elizabeth Kenny Foundation	100
Y. M. C. A., South Pasadena	1,000

Be It Further Resolved: That should there be any further interest or dividends received prior to the end of the fiscal year and not disposed of as above recommended, then the President of this corporation is hereby authorized to make gifts of such additional amounts to any or all of the above-mentioned tax-exempt institutions.

Discussion was then had concerning the status of the Foundation as recognized by the Internal Revenue Department, and upon motion duly made, seconded and carried, the following resolution was adopted:

Resolved: That the President of this corporation be and he is hereby authorized and directed to have counsel for the Foundation prepare and file additional petition, or letter, with the Bureau of Internal Revenue, asking for reconsideration of the status of the Foundation, and setting forth as suggested by

Counsel recent decisions in the District Courts and the Court of Claims which appear to be favorable to the contentions of the Foundation.

Be It Further Resolved: That the President take such other steps as he may deem [83] advisable toward accomplishing recognition by the Department of Internal Revenue of the tax-exempt status of this Foundation.

There being no further business to come before the meeting, the meeting was upon motion duly made, seconded and carried, adjourned.

/s/ DOROTHY R. WARD,
Secretary.

Approved:

/s/ PAUL RANDALL,
President.

/s/ DOROTHY R. WARD,

/s/ F. W. BAILES,

/s/ JAMES A. FLANAGAN,

/s/ J. P. PATTERSON. [84]

Minutes of Meeting of Board of Trustees
of Randall Foundation, Inc.

Held on the 15th day of May, 1952,
at the Principal Office
At 2:00 o'Clock P.M.

The meeting was called to order by the President, Paul M. Randall, and upon roll being called, a quorum was found to be present.

The President stated that the purpose of the meeting was to read the financial report for the fiscal year ending April 30, 1952, as prepared by Sidney R. Reed & Company. The financial report was then read, and a discussion had, whereupon, the following resolution, upon motion duly made and seconded, was passed:

Resolved: That the financial report as prepared and presented to the meeting, for the fiscal year ending April 30, 1952, be and the same is hereby approved and each and all of the purchases and sales set forth therein, and each and all of the expenditures set forth therein, and each and all of the contributions set forth therein, are hereby confirmed and approved.

There being no further business to come before the meeting, the meeting was upon motion duly made, seconded and carried, adjourned.

/s/ DOROTHY R. WARD,
Secretary.

Approved:

/s/ PAUL RANDALL,
President.

/s/ F. W. BAILES,

/s/ JAMES A. FLANAGAN. [85]

Special Meeting of the Board of Trustees
of Randall Foundation, Inc.

Held June 18th, 1952, at the Principal Office
At 2:00 o'Clock P.M.

A special Meeting of the Board of Trustees of Randall Foundation, Inc., was held on the 18th day of June, 1952, at 2:00 o'clock p.m. at the principal office of the Foundation, the County of Los Angeles, State of California.

The meeting was called to order by the President, Paul M. Randall. Upon roll being called, a quorum was found to be present.

Mr. Randall stated to the meeting that the purpose of the special call was to consider a gift in a substantial amount to Cate School in Carpinteria, California. Mr. Randall explained to the meeting the status of the Foundation with respect to the matter of tax exemption and read the recent correspondence with the Internal Revenue Department in Washington regarding same, and told of the recent letter just filed with the Internal Revenue Department seeking reconsideration and favorable action at this time. A discussion was had, and there-

after, upon motion being duly made and seconded and vote being taken, the following resolution was duly passed.

Resolved: That Randall Foundation, Inc., by and through its President, Paul M. Randall, agree by written subscription or otherwise, to give to Cate School, located at Carpinteria, California, the sum of Ten Thousand Dollars ($10,000.00) on August 16, 1952, provided that and on the condition that on or before August 15, 1952, the Internal Revenue Department has granted to Randall Foundation, Inc., without reservation the tax exemption sought by the Foundation pursuant to its letters and application heretofore filed, and that Randall Foundation, Inc., by such action be [86] recognized as a tax-exempt organization or institution from its inception, and

Be It Further Resolved: That if the condition, or proviso, aforesaid is fulfilled on or before August 15, 1952, that the said Paul M. Randall, President of Randall Foundation, Inc., be and he is hereby authorized to execute and deliver the check of the Foundation in the aforesaid amount to carry out the intent of this resolution, and

Be It Further Resolved: That if Randall Foundation, Inc., does not secure its tax-exempt status on or before August 15, 1952, then this proposed or intended gift shall be of no further force and effect, and this authorization will terminate, and

Be It Further Resolved: That Paul M. Randall be and he is hereby authorized to deliver a copy of

this resolution to Cate School or its representatives to serve as the agreement of this Foundation to give to Cate School the sum of $10,000.00 provided that and on the condition that the tax-exempt status of Randall Foundation, Inc., from its inception has been secured on or before August 15, 1952, this gift not to be made, according to the intent of the resolution, if tax exemption is not secured by such date.

There being no further business to come before the meeting, the meeting was, upon motion duly made, seconded and passed, adjourned.

/s/ DOROTHY R. WARD,
Secretary.

Approved:

/s/ PAUL RANDALL,
President. [87]

Minutes of Special Meeting of Board of Trustees of Randall Foundation, Inc.

Held August 10th, 1952, at the Principal Office At 2:00 o'Clock P.M.

The meeting was called to order by the President, Paul M. Randall, and upon roll being called, a quorum of the Trustees was found to be present.

The President stated to the meeting that in view of the fact that the present representatives of the Foundation had been unable through negotiation to secure a tax-exempt status for the Foundation and in view of the fact that litigation appeared neces-

sary, he had retained the firm of Hill & Barnes of Washington, D. C., to represent the Foundation and had paid them a retainer fee in connection therewith. He then explained to the meeting the arrangement with Hill & Barnes and asked that the Board approved their employment. After discussion had and upon motion being duly made and seconded and vote being taken, the following resolution was unanimously passed:

Resolved: That the employment by Paul M. Randall of the firm of Hill & Barnes of Washington, D. C., to represent the Foundation in its effort to secure a tax-exempt status from the Department of Internal Revenue be, and the same is hereby, approved and the arrangements with respect to such representation are hereby approved; and

Be It Further Resolved: That the President of this corporation and such other officers thereof as may be required in connection therewith be, and they are hereby authorized to take any and all steps on behalf of the foundation and execute any and all papers on behalf of the Foundation prepared by or suggested by the aforesaid law firm with respect to [88] securing tax-exempt status for the Foundation, including any and all papers in connection with any litigation advised by said firm.

There being no further business to come before the meeting, said meeting was, upon motion duly made, seconded and carried, adjourned.

/s/ DOROTHY R. WARD,
Secretary. [89]

Regular Meeting of Board of Trustees Held at the Principal Office of the Corporation on the Last Monday in September, To Wit, September 29, 1952, at the Hour of 2:15 P.M.

The meeting was called to order by the President, Paul Randall, and upon the roll being called, four of the five trustees were found to be present, to wit: Paul Randall, Dorothy R. Ward, Frederick W. Bailes and James A. Flanagan.

The President stated that the first order of business was to consider certain amendments to the articles of incorporation in order that said articles might more truly set forth the intent of the corporation with respect to its primary purpose, and to consider other amendments to conform to the intentions of the corporation which would likewise be advisable for the corporation to adopt. After discussion had and upon motion duly made, seconded and the vote being taken, the following resolution was unanimously adopted:

Resolved: That the following amendments to the articles of incorporation of Randall Foundation, Inc., be and the same are hereby adopted:

One: Article II of said articles is hereby amended to read as follows:

II.

That the specific and primary purpose for which said corporation is formed is to establish a home for under-privileged boys, without regard to race,

creed or color. It shall be the purpose of this home to prevent and cure waywardness among boys by providing a wholesome home with facilities for education and the teaching of useful trades or occupations.

Two: Article III of said articles is hereby amended to read as follows:

III.

That in order to carry out the aforesaid purpose the [90] corporation shall have the power and right to engage in those activities permitted by law to a non-profit corporation organized under the laws of the State of California under the title aforesaid and under Section 101 (6) of the United States Internal Revenue Code and as selected from time to time by the Board of Trustees with a view to creating funds and sources of revenue for the creation and maintenance of the aforesaid home.

Three: Article VIII of said articles is hereby amended to read as follows:

VIII.

No member shall have any proprietary interest whatever in or to any of the assets of the corporation, and no income, increments, or other pecuniary gain, benefit, or advantage of any kind, in any way arising from or growing out of the assets of the corporation or their operation will inure to or in any way go to or vest in any member of the corporation.

Four: The following article shall be added to the articles of incorporation and designated as Article IX and shall read as follows:

IX.

Upon the dissolution or winding up of the corporation after paying or adequately providing for the debts and obligations of the corporation, any remaining assets shall be distributed to such religious, educational or charitable organizations as may be selected by the Board of Trustees; however, the Board of Trustees may designate only such organizations as are located in the State of California and which qualify as exempt organizations under the provisions of Section 101 (6) of the United States Internal Revenue Code.

Resolved Further that such number of the incorporators and/or trustees of this corporation as may be required by law to execute, adopt and file a certificate of amendment setting forth the amendments to the articles of incorporation hereinabove adopted take [91] such steps as may be requisite for such purpose and do any and all things required by law to make the amendments hereinabove adopted effective and complete for all purposes of the corporation.

The president then stated that the next order of business was to consider amendments to the bylaws which would be in conformance with the intent and purposes of the Board of Trustees and also conform to the amendments made in the articles of

incorporation. After discussion had and upon motion duly made, seconded, and vote being taken, the following resolution was unanimously passed:

Resolved that the bylaws of Randall Foundation, Inc., be and the same are hereby amended in the following respects, to wit:

One: Subparagraphs (3) and (4) of Article III of the bylaws are hereby amended to read as follows:

(3) To incur indebtedness for purposes of the corporation, the terms and amounts of such indebtedness to be entered upon the usual books of the corporation; to invest the funds of the corporation for the purpose of building up a fund for the erection and maintenance of the home described in Article II of the Amended Articles of Incorporation of this corporation.

(4) To perform all other duties and exercise all other powers permitted by law to be done or exercised by the trustees or members of a non-profit organization organized under Part I of Division 2 of Title I of the Corporation Code of the State of California, and permitted by Section 101 (6) of the United States Internal Revenue Code.

Two: Article VII of the bylaws as it now reads is deleted and said Article VII shall read as follows:

VII.

No member shall have any proprietary interest whatever in or to any of the assets of the corpora-

tion, and no income, increment, or other pecuniary gain, benefit or advantage of any kind, in any way arising from or growing out of the assets of the corporation or their operation will inure to or in any way go to or vest in any member of [92] the corporation.

Three: There shall be added to the bylaws an Article VIII, which said Article VIII shall read as follows:

VIII.

It is intended that in accomplishing the primary purpose of the corporation as set forth in Article II of the articles of incorporation, construction of the home described in said Article II be commenced by December 31, 1957, or that the corporation establish facilities for the actual residence of at least 50 inmates not later than December 31, 1959.

If the corporation fails in the accomplishment of the primary purpose set forth in Article II of the articles of incorporation, then the trustees shall consider appropriate resolutions for dissolution of the corporation after paying or adequately providing for the debts and obligations of the corporation. Any remaining assets shall be distributed to such religious, educational or charitable organizations as may be selected by the Board of Trustees; however, the Board of Trustees may designate only such organizations as are located in the State of California and which qualify as exempt organizations under the provisions of Section 101 (6) of the United States Internal Revenue Code.

In the event that the corporation shall be dissolved in accordance with the provisions of this Article VIII, the trustees shall make distribution to exempt organizations within 12 months of the date of the resolution dissolving the corporation.

Resolved Further that a complete copy of the bylaws as amended be now made and attached to these Minutes and that said bylaws as amended be made a part of the books and records of this corporation.

There being no further business to come before the meeting, [93] the meeting was upon motion duly made and seconded, and vote being taken, adjourned.

/s/ DOROTHY R. WARD,
Secretary.

Approved:

/s/ PAUL RANDALL,
President.

This is to certify that I am the duly elected, qualified and acting secretary of Randall Foundation, Inc., and that a regular meeting of the Board of Trustees of Randall Foundation, Inc., was duly and regularly held on the last Monday in September, to wit, September 29, 1952, at the hour of 2:15 p.m., at the principal office of the corporation, in accordance with the provisions of the bylaws of the corporation with respect to such regular meeting, and that at said meeting there were at all times present and acting a quorum of the Board of

Trustees, to wit, four of the five trustees of said corporation, and that the within Minutes to which this certification is attached are the Minutes of said regular meeting so held, and that at said meeting the resolutions set forth in the within Minutes, including the resolutions specifically amending the articles of incorporation and amending the bylaws of the corporation, were duly and regularly passed.

In Witness Whereof I have hereunto set my hand this 30th day of September, 1952.

/s/ DOROTHY R. WARD,
Secretary. [94]

Minutes of Special Meeting of Board of Trustees of Randall Foundation, Inc.

Held on the 7th day of April, 1953, at 128 South La Brea Avenue, Los Angeles, California, at the Hour of 3:00 P.M.

The meeting was called to order by the President, Paul M. Randall, and upon the roll being called a quorum of the Trustees was found to be present.

Mr. Paul M. Randall stated to the meeting that Dorothy R. Ward, Secretary of the Foundation, had asked that her resignation be accepted and that it would, consequently, be necessary for the Board to elect a new Secretary. He also stated that he had received from the law firm of Hill & Barnes in Washington, D. C., certain recommendations with

respect to procedure in connection with securing a tax-exempt status of the Foundation, and such letter will be read to the meeting.

Upon motion duly made and seconded and vote being taken, the resignation of Dorothy R. Ward as secretary was accepted. Upon nomination then being made and the nominations duly closed and vote being taken, J. P. Patterson was duly elected Secretary of the corporation.

The letter of Hill & Barnes was then read to the meeting, and after discussion had, the following resolution was duly adopted:

Resolved, That Whereas, Hill & Barnes have advised that this Foundation not file tax returns for the fiscal years 1950-1951 and 1951-1952 as prepared by the office of Sydney R. Reed, and that the Foundation adopt a procedure as set forth in the letter, hastening the setting of the litigation of the Foundation and the Internal Revenue [95] Department with respect to the tax-exempt status; and

Whereas, Sydney R. Reed has advised that said tax returns be filed and that a procedure be adopted which would postpone the litigation above referred to and would allow certain conferences with the Department prior to any such litigation.

Now, Therefore, be it resolved that the President, Paul M. Randall, secure the opinion of a third tax expert with respect to the procedure to be followed and report back to this Board at its next meeting for final action by the Board.

There being no further business to come before the meeting, the meeting was, upon motion duly made, seconded and carried, adjourned.

/s/ J. P. PATTERSON,
Secretary. [96]

Minutes of Special Meeting of Board of Trustees of Randall Foundation, Inc.

Held at 922 Citizens National Bank Bldg.
June 16th, 1953

The meeting was called to order by the President, Paul Randall, and upon the roll being called a quorum of the Board was found to be present.

The Chairman stated that the purpose of the meeting was to act upon the resignation of Dorothy R. Ward, who was not present at the meeting but who had submitted her written resignation, and upon motion being duly made and seconded and vote being taken the resignation of Dorothy R. Ward was duly accepted and the resignation ordered attached to the minutes of the meeting.

The president then stated that the meeting was open to nominations to fill the vacancy caused by the resignation of Dorothy R. Ward, and upon nominations being duly made and seconded and the nominations then duly closed and vote being taken, May C. Gifford of Los Ageles, California, was duly elected a member of the Board of Trustees of the Foundation.

J. P. Patterson then presented to the meeting his resignation as secretary, and upon motion being duly made and seconded and vote being taken said resignation was accepted.

The Chairman then stated that the meeting would proceed with the election of a secretary to fill the vacancy created by Mr. Patterson's resignation, and upon motion being duly made and seconded and nominations duly closed and vote being taken May C. Gifford was duly elected the secretary of the Foundation.

There being no further business to come before the meeting, the meeting was upon motion being duly made, seconded and carried, adjourned.

/s/ J. P. PATTERSON,
Secretary.

Approved:

/s/ PAUL M. RANDALL,

/s/ JAMES A. FLANAGAN. [97]

Los Angeles, California,
June .., 1953.

To: The Board of Trustees, Randall Foundation, Inc.

Gentlemen:

I hereby tender my resignation as secretary of the Foundation.

Very truly yours,

/s/ J. P. PATTERSON.

[Endorsed]: Filed October 8, 1954. [98]

[Title of District Court and Cause.]

MINUTE ORDER

The judgment will be for the defendant. Counsel will prepare and submit Findings of Fact, Conclusions of Law, and Judgment under the Rules.

Dated: Los Angeles, California, April 6, 1955.

/s/ PEIRSON M. HALL,
United States District Judge.

[Endorsed]: Filed April 6, 1955. [98-A]

United States District Court for the Southern District of California, Central Division

No. 16142-PH Civil

RANDALL FOUNDATION, INC.,

Plaintiff,

vs.

ROBERT A. RIDDELL, Director of Internal Revenue, District of Los Angeles,

Defendant.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT

This cause came on for hearing on October 11, 1954, before the Hon. Peirson M. Hall, Judge, presiding, without the intervention of a jury. Plaintiff was represented by its counsel, Gibson, Dunn &

Crutcher, through Bert A. Lewis, and the defendant was represented by his counsel, Laughlin E. Waters, United States Attorney, Southern District of California; Edward R. McHale, Assistant United States Attorney, Chief, Tax Division, and Robert H. Wyshak, Assistant United States Attorney. The Court, having heard and considered all the evidence and stipulations of fact, makes the following findings of fact and conclusions of law:

Findings of Fact

I.

This is an action for recovery of corporate income taxes assessed and paid pursuant to the provisions of the 1939 Internal [99] Revenue Code, and jurisdiction is based on Title 28, U.S.C. § 1340.

II.

On May 11, 1950, the plaintiff was organized as a non-profit corporation under the laws of the State of California. Its articles provided that its purpose was the promotion and advancement of charitable, religious and educational projects on a non-profit basis and that no member should have any proprietary interest in the assets or income of the plaintiff. The original Board of Trustees consisted of Paul M. Randall, Frank R. Randall, his son; Dorothy R. Ward, his sister; Frederick W. Bailes, and James A. Flanagan.

III.

The plaintiff's capital consisted of contributions by Paul Randall during its first fiscal year ended

April 30, 1951, of shares of stock with a market value of $20,752.11 owned by him and in which he had a substantial profit. Some of these were sold by the plaintiff the same day or the day following the contribution. No gain was reported either by the plaintiff or Paul Randall on the disposition of the shares of stock so that the difference between the sale price and the original purchase price by Paul Randall was unreported as taxable income.

IV.

Between June 13, 1950, and April 5, 1951, Paul Randall loaned to the plaintiff a total of $155,200.00 at an interest rate of 2½% per annum. Said monies had been borrowed by Randall from his brokers on his personal margin account with his own securities as collateral. At the time of the first loan, the interest rate at which he was borrowing was only 2% per annum, with subsequent increases to 3%. Said loans were repaid as follows: $40,000.00 on May 29, 1951; $30,000.00 on December 27, 1951; and $85,200.00 on February 4, 1952.

V.

With the proceeds from the sales of the initial contributions [100] and said loans, the plaintiff traded in securities most of which were oil stocks listed on the Los Angeles Stock Exchange. The result was a net profit from securities transactions during its fiscal year ended April 30, 1951, of $30,238.27. In addition, dividends from these stocks totaled $10,285.00. These were the plaintiff's only

activities during its first year of existence. In that year 26,908 shares of stock were bought and 23,185 shares of stock were sold. Of these transactions, sales of only 150 shares resulted in long-term gain; the remaining sales were short-term transactions, i.e., where the securities were held for six months or less.

VI.

One week before the close of the first fiscal year a $500.00 contribution was made to the Children's Hospital Association of Los Angeles. This was a little more than 1% of the plaintiff's gross income for its first year of operation. Its expenses for said year amounted to $1,532.36. No charitable activity whatsoever was engaged in by the plaintiff during this period except for this one contribution. Shortly after the first fiscal year ended April 30, 1951, plaintiff filed a request with the Internal Revenue Service for a ruling that it was exempt from income tax under § 101 (6) of the 1939 Internal Revenue Code. The Commissioner of Internal Revenue ruled that it was not entitled to exemption as follows:

"It is the opinion of this office that the income received by you has not been devoted to the purposes for which you were incorporated in such a manner and to such an extent as to constitute operations for such purposes within the meaning of section 101 (6) of the Code. Furthermore, your activities are primarily those of an organization engaged in the ordinary business of buying and selling securities. An organization which is operated for the

primary purpose [101] of carrying on a trade or business for profit is not exempt from Federal income tax notwithstanding all of its profits are payable to organizations or purposes specified in section 101 (6) of the Internal Revenue Code."

VII.

During its second fiscal year the foundation's activities were in large part unchanged from the prior year. Randall contributed to the plaintiff securities with a market value of only $672.97. No gifts or contributions were at any time solicited from or made by any other person. Profit from security transactions totaled $50,079.61 and dividends totaled $7,081.93, for a total gross income of $58,-161.54. Expenses for said year, incurred in large part in order to obtain exemption from income tax, totaled $8,271.99. Gains were both long and short term and resulted from the sale of 25,996 shares of stock and the purchase of 15,936 shares of stock. $11,200.00 was contributed to various charities during this second fiscal year. However, almost 75% of it was contributed on the last day of the fiscal year, despite the fact that income was being earned throughout the year. The Board of Trustees felt that these contributions might help secure a tax-exempt status for the plaintiff. No charitable activity was directly carried on by the plaintiff during the second fiscal year.

VIII.

The trading was carried on on behalf of the corporation through two brokerage houses, Akin-

Lambert & Company, Inc., and Harbison & Henderson Company. The same customer's men who had serviced Paul Randall in his individual capacity executed orders from Paul Randall on behalf of the foundation. He had been authorized by the Board of Trustees so to make trades without regard to the nature of the security and without further formal authority from the Board. After Paul Randall started trading on behalf of the foundation, his market activities on his own behalf diminished considerably. [102]

IX.

In the meantime the foundation filed several requests for reconsideration of the ruling with the Internal Revenue Service, which culminated in a ruling dated January 8, 1953, which concluded as follows:

"A review has been made of the evidence which formed the basis of Bureau rulings of September 12, 1951, January 15, 1952, and June 16, 1952, in connection with the information subsequently submitted and the statements made at conferences held with representatives of this office in connection with this matter. It is believed on the basis of the facts and evidence submitted, that your activities have been primarily those of an organization engaged in the ordinary business of buying and selling securities, and that there is no error in the conclusion reached in Bureau rulings of September 12, 1951, January 15, 1952, and June 16, 1952, and they are therefore hereby affirmed."

X.

The plaintiff then filed its income tax returns for the fiscal years ending April 30, 1951, and April 30, 1952, disclosing a tax liability of $6,677.13 for the year ended April 30, 1951, and $14,113.24 for the year ended April 30, 1952. These amounts were paid to the District Director of Internal Revenue at Los Angeles on or about June 10, 1953. Claims for refund therefor were filed with said Director on June 12, 1953. Said claims were not acted upon by the Commissioner of Internal Revenue.

XI.

The plaintiff was not organized or operated exclusively for a charitable purpose during the fiscal years ending April 30, 1951, and April 30, 1952, within the meaning of § 101 (6) of the 1939 [103] Internal Revenue Code.

XII.

The plaintiff was operated during the fiscal years ended April 30, 1951, and April 30, 1952, for the primary purpose of carrying on a trade or business for profit.

XIII.

All of the income realized by the plaintiff during the fiscal years ended April 30, 1951, and April 30, 1952, was derived from the operation of its business of buying and selling securities.

Conclusions of Law

I.

The Court has jurisdiction of the parties and of this controversy.

II.

The plaintiff was not organized or operated exclusively for a charitable purpose during the fiscal years ending April 30, 1951, and April 30, 1952, within the meaning of § 101 (6) of the 1939 Internal Revenue Code.

III.

The plaintiff is not entitled to exemption from federal income taxation with respect to the fiscal years ended April 30, 1951, and April 30, 1952. under either § 101 (6) or § 101 (14) of the 1939 Internal Revenue Code.

IV.

The plaintiff is not exempt from federal income taxation for the fiscal year ended April 30, 1951, under the provisions of § 302 (a) of the Revenue Act of 1950.

V.

The plaintiff is not exempt from federal income taxation for the fiscal year ended April 30, 1952, as it is within § 301 (b) of the Revenue Act of 1950, which was incorporated in the 1939 Internal Revenue [104] Code as an amendment to § 101 (6).

VI.

The rulings of the Commissioner of Internal Revenue that the plaintiff was not entitled to

exemption from taxation for the fiscal years ended April 30, 1951, and April 30, 1952, were not erroneous.

VII.

The plaintiff was operated during the fiscal years ended April 30, 1951, and April 30, 1952, for the primary purpose of carrying on a trade or business for profit.

VIII.

All of the income realized by the plaintiff during the fiscal years ended April 30, 1951, and April 30, 1952, was derived from the operation of its business of speculating by buying and selling securities.

IX.

The defendant is entitled to judgment against the plaintiff dismissing the complaint herein with prejudice, and for his costs.

Judgment

In accordance with the foregoing findings of fact and conclusions of law, it is hereby ordered, adjudged and decreed:

That the plaintiff take nothing by its complaint, that the above-entitled action be dismissed with prejudice, and that the defendant have judgment for and shall recover from plaintiff the amount of defendant's costs, to be taxed by the Clerk of this Court in the sum of $.....

Dated: This 23rd day of January, 1956.

/s/ PEIRSON M. HALL,
United States District Judge.

Affidavit of Service by Mail attached.

Lodged January 18, 1956.

[Endorsed]: Filed and entered January 23, 1956. [105]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that Randall Foundation, Inc., hereby appeals to the United States Court of Appeals for the Ninth Circuit from that certain judgment heretofore and on or about January 23, 1956, entered in the above-entitled action and from the whole of said judgment.

GIBSON, DUNN & CRUTCHER,

By /s/ BERT A. LEWIS,
Attorneys for Plaintiff.

Receipt of copy acknowledged.

[Endorsed]: Filed February 20, 1956. [107]

[Title of District Court and Cause.]

STIPULATION EXTENDING TIME FOR FILING OF BOND FOR COSTS ON APPEAL

It is hereby stipulated and agreed, by and between the attorneys for the parties hereto, subject to the order of the court, that the time within which Plaintiff-Appellant shall file bond for costs on appeal to the United States Court of Appeals for the Ninth Circuit be extended to and including February 23, 1956.

Dated: February 23, 1956.

GIBSON, DUNN & CRUTCHER,

/s/ BERT A. LEWIS,
Attorneys for Plaintiff-Appellant.

LAUGHLIN E. WATERS,
United States Attorney;

EDWARD R. McHALE,
Asst. U. S. Attorney, Chief, Tax Division;

ROBERT H. WYSHAK,
Asst. U. S. Attorney;

/s/ ROBERT H. WYSHAK,
Attorneys for Defendant-Appellee.

So Ordered: February 23, 1956.

/s/ PEIRSON M. HALL,
United States District Judge.

[Endorsed]: Filed February 23, 1956. [110]

United States District Court for the Southern District of California, Central Division

No. 16142-PH Civil

RANDALL FOUNDATION, INC.,

Plaintiff,

vs.

ROBERT A. RIDDELL, Director of Internal Revenue, District of Los Angeles,

Defendant.

CORRECTED FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT NUNC PRO TUNC

This cause came on for hearing on October 11, 1954, before the Hon. Peirson M. Hall, Judge, presiding, without the intervention of a jury. Plaintiff was represented by its counsel, Gibson, Dunn & Crutcher, through Bert A. Lewis, and the defendant was represented by his counsel, Laughlin E. Waters, United States Attorney, Southern District of California; Edward R. McHale, Assistant United States Attorney, Chief, Tax Division, and Robert H. Wyshak, Assistant United States Attorney. The Court, having heard and considered all the evidence and stipulations of fact, makes the following findings of fact and conclusions of law:

Findings of Fact

I.

This is an action for recovery of corporate income taxes assessed and paid pursuant to the pro-

visions of the 1939 Internal [111] Revenue Code, and jurisdiction is based on Title 28, U.S.C. § 1340.

II.

On May 11, 1950, the plaintiff was organized as a non-profit corporation under the laws of the State of California. Its articles provided that its purpose was the promotion and advancement of charitable, religious and educational projects on a non-profit basis and that no member should have any proprietary interest in the assets or income of the plaintiff. The original Board of Trustees consisted of Paul M. Randall, Frank R. Randall, his son; Dorothy R. Ward, his sister; Frederick W. Bailes, and James A. Flanagan.

III.

The plaintiff's capital consisted of contributions by Paul Randall during its first fiscal year ended April 30, 1951, of shares of stock with a market value of $20,752.11 owned by him and in which he had a substantial profit. Some of these were sold by the plaintiff the same day or the day following the contribution. No gain was reported either by the plaintiff or Paul Randall on the disposition of the shares of stock so that the difference between the sale price and the original purchase price by Paul Randall was unreported as taxable income.

IV.

Between June 13, 1950, and April 5, 1951, Paul Randall loaned to the plaintiff a total of $155,200.00 at an interest rate of 2½% per annum. Said monies

had been borrowed by Randall from his brokers on his personal margin account with his own securities as collateral. At the time of the first loan, the interest rate at which he was borrowing was only 2% per annum, with subsequent increases to 3%. Said loans were repaid as follows: $40,000.00 on May 29, 1951; $30,000.00 on December 27, 1951; and $85,200.00 on February 4, 1952. [112]

V.

With the proceeds from the sales of the initial contributions and said loans, the plaintiff traded in securities most of which were oil stocks listed on the Los Angeles Stock Exchange. The result was a net profit from securities transactions during its fiscal year ended April 30, 1951, of $30,238.27. In addition, dividends from these stocks totaled $10,285.00. These were the plaintiff's only activities during its first year of existence. In that year 26,908 shares of stock were bought and 23,185 shares of stock were sold. Of these transactions, sales of only 150 shares resulted in long-term gain; the remaining sales were short-term transactions, i.e., where the securities were held for six months or less. [All sales and purchases of securities were made by Paul Randall on behalf of the plaintiff as a trader and not as a dealer.]

VI.

One week before the close of the first fiscal year a $500.00 contribution was made to the Children's Hospital Association of Los Angeles. This was a

little more than 1% of the plaintiff's gross income for its first year of operation. Its expenses for said year amounted to $1,532.36. No charitable activity whatsoever was engaged in by the plaintiff during this period except for this one contribution. Shortly after the first fiscal year ended April 30, 1951, plaintiff filed a request with the Internal Revenue Service for a ruling that it was exempt from income tax under § 101 (6) of the 1939 Internal Revenue Code. The Commissioner of Internal Revenue ruled that it was not entitled to exemption as follows:

"It is the opinion of this office that the income received by you has not been devoted to the purposes for which you were incorporated in such a manner and to such an extent as to constitute operations for [113] such purposes within the meaning of section 101 (6) of the Code. Furthermore, your activities are primarily those of an organization engaged in the ordinary business of buying and selling securities. An organization which is operated for the primary purpose of carrying on a trade or business for profit is not exempt from Federal income tax notwithstanding all of its profits are payable to organizations or purposes specified in section 101 (6) of the Internal Revenue Code."

VII.

During its second fiscal year the foundation's activities were in large part unchanged from the prior year. Randall contributed to the plaintiff securities

with a market value of only $672.97. No gifts or contributions were at any time solicited from or made by any other person. Profit from security transactions totaled $50,079.61 and dividends totaled $7,081.93, for a total gross income of $58,161.54. Expenses for said year, incurred in large part in order to obtain exemption from income tax, totaled $8,271.99. Gains were both long and short term and resulted from the sale of 25,996 shares of stock and the purchase of 15,936 shares of stock. $11,200.00 was contributed to various charities during this second fiscal year. However, almost 75% of it was contributed on the last day of the fiscal year, despite the fact that income was being earned throughout the year. The Board of Trustees felt that these contributions might help secure a tax-exempt status for the plaintiff No charitable activity was directly carried on by the plaintiff during the second fiscal year.

VIII.

The trading was carried on on behalf of the corporation through two brokerage houses, Akin-Lambert & Company, Inc., and [114] Harbison & Henderson Company. The same customer's men who had serviced Paul Randall in his individual capacity executed orders from Paul Randall on behalf of the foundation. He had been authorized by the Board of Trustees so to make trades without regard to the nature of the security and without further formal authority from the Board. After Paul Randall started trading on behalf of the foundation, his

market activities on his own behalf diminished considerably.

IX.

In the meantime the foundation filed several requests for reconsideration of the ruling with the Internal Revenue Service, which culminated in a ruling dated January 8, 1953, which concluded as follows:

"A review has been made of the evidence which formed the basis of Bureau rulings of September 12, 1951, January 15, 1952, and June 16, 1952, in connection with the information subsequently submitted and the statements made at conferences held with representatives of this office in connection with this matter. It is believed on the basis of the facts and evidence submitted, that your activities have been primarily those of an organization engaged in the ordinary business of buying and selling securities, and that there is no error in the conclusion reached in Bureau rulings of September 12, 1951, January 15, 1952, and June 16, 1952, and they are therefore hereby affirmed."

X.

The plaintiff then filed its income tax returns for the fiscal years ending April 30, 1951, and April 30, 1952, disclosing a tax liability of $6,677.13 for the year ended April 30, 1951, and $14,113.24 for the year ended April 30, 1952. These amounts [115] were paid to the District Director of Internal Revenue at Los Angeles on or about June 10, 1953.

Claims for refund therefor were filed with said Director on June 12, 1953. Said claims were not acted upon by the Commissioner of Internal Revenue.

XI.

The plaintiff was not organized or operated exclusively for a charitable purpose during the fiscal years ending April 30, 1951, and April 30, 1952, within the meaning of §101(6) of the 1939 Internal Revenue Code.

XII.

The plaintiff was operated during the fiscal years ended April 30, 1951, and April 30, 1952, for the primary purpose of carrying on a trade or business for profit.

XIII.

All of the income realized by the plaintiff during the fiscal years ended April 30, 1951, and April 30, 1952, was derived from the operation of its business of buying and selling securities.

Conclusions of Law

I.

The Court has jurisdiction of the parties and of this controversy.

II.

The plaintiff was not organized or operated exclusively for a charitable purpose during the fiscal years ending April 30, 1951, and April 30, 1952, within the meaning of §101(6) of the 1939 Internal Revenue Code.

III.

The plaintiff is not entitled to exemption from federal income taxation with respect to the fiscal years ended April 30, 1951, and April 30, 1952, under either §101(6) or §101(14) of the 1939 Internal Revenue Code. [116]

IV.

The plaintiff is not exempt from federal income taxation for the fiscal year ended April 30, 1951, under the provisions of §302(a) of the Revenue Act of 1950.

V.

The plaintiff is not exempt from federal income taxation for the fiscal year ended April 30, 1952, as it is within §301(b) of the Revenue Act of 1950, which was incorporated in the 1939 Internal Revenue Code as an amendment to §101(6).

VI.

The rulings of the Commissioner of Internal Revenue that the plaintiff was not entitled to exemption from taxation for the fiscal years ended April 30, 1951, and April 30, 1952, were not erroneous.

VII.

The plaintiff was operated during the fiscal years ended April 30, 1951, and April 30, 1952, for the primary purpose of carrying on a trade or business for profit.

VIII.

All of the income realized by the plaintiff during the fiscal years ended April 30, 1951, and April 30,

1952, was derived from the operation of its business of speculating by buying and selling securities.

IX.

The defendant is entitled to judgment against the plaintiff dismissing the complaint herein with prejudice, and for his costs.

Judgment

In accordance with the foregoing findings of fact and conclusions of law, it is hereby ordered, adjudged and decreed:

That the plaintiff take nothing by its complaint, that the above-entitled action be dismissed with prejudice, and that the [117] defendant have judgment for and shall recover from plaintiff the amount of defendant's costs, to be taxed by the Clerk of this Court in the sum of $.....

Dated: This 1st day of March, 1956.

/s/ PEIRSON M. HALL,
United States District Judge.

Affidavit of Service by Mail Attached.

Lodged February 28, 1955.

[Endorsed]: Filed and entered March 1, 1956.

In the United States District Court, Southern District of California, Central Division

No. 16142-PH Civil

RANDALL FOUNDATION, INC.,

Plaintiff,

vs.

ROBERT A. RIDDELL, Director of Internal Revnue, District of Los Angeles,

Defendant.

Honorable Peirson M. Hall, Judge Presiding.

REPORTER'S TRANSCRIPT OF PROCEEDINGS

October 11, 1954

Appearances:

For the Plaintiff:
GIBSON, DUNN & CRUTCHER,
634 South Spring Street,
Los Angles 13, California; by
BERT A. LEWIS, ESQ.

For the Defendant:
LAUGHLIN E. WATERS,
United States Attorney,
Los Angeles 12, California; by
ROBERT WYSHAK,
Assistant United States Attorney.

October 11, 1954—11:45 A.M.

(Other court matters.)

The Court: Randall vs. Riddell.

Mr. Lewis: Your Honor, we are ready with our witnesses. I understand Government counsel has something to say.

The Court: Is the stipulation on file?

Mr. Wyshak: It was filed Friday afternoon, your Honor.

The Court: It has not gotten to the file yet. Do you have an extra copy of it?

Mr. Lewis: I have, your Honor.

(The document referred to was passed to the Court.)

Mr. Wyshak: Your Honor, perhaps I misunderstood you when I spoke to you on the telephone but I have arranged to have the Revenue Agent here at 1:30 o'clock.

The Court: I thought you said your witnesses are here now.

Mr. Wyshak: No, your Honor. Mr. Lewis said he would be agreeable to going on at 2:00 o'clock this afternoon, and I thought I understood you to say you were free this afternoon.

The Court: I will put it over until 2:00 o'clock. In the meantime maybe we can find the court's copy of the stipulation.

Mr. Wyshak: Thank you, your Honor.

(Whereupon, at 12:00 o'clock noon, a recess was taken until 2:00 o'clock p.m. of the same date.) [4*]

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

October 11, 1954—2:00 P.M.

The Court: Randall vs. Riddell.

Mr. Lewis: Ready, your Honor.

Mr. Wyshak: Ready for the Government.

Mr. Lewis: I understand we now have the stipulation of facts?

The Court: Yes, I have the stipulation of facts and I have glanced at it casually.

Mr. Lewis: I might say that there is one place where it is reversed. We mentioned in the stipulation of facts on page 7 thereof, Paragraph X, the references to Schedules E and F of the complaint. They are transposed, that is, Schedule E gives the data for the year ended April 30, 1951, and Schedule F gives the data for April 30, 1952. The years are just reversed.

The Court: Then I will just change this Schedule F on line 18 and Schedule E on line 21, is that right?

Mr. Lewis: That is right, your Honor.

Your Honor will recall that the issue in this case is whether the Foundation qualified as an organization operated and organized exclusively for charitable purposes. It made such a claim to the Bureau of Internal Revenue, and in a series of rulings the Bureau denied the exemption. Therefore the Randall Foundation paid the tax, filed a claim for [5] refund, no action was taken on the claim for refund, and this action was commenced.

Most of the facts have been stipulated to, your Honor, but I have in Court several of the directors

of the Foundation whom I would like to elicit some testimony from.

The Court: Very well.

The stipulation of facts has been signed, and this is not a stipulation that if witnesses were called they would testify so-and-so, but this is a stipulation that they are facts.

Mr. Wyshak: That is correct, your Honor.

The Court: Very well. The stipulation of facts will be received in evidence.

Mr. Wyshak: There are several objections that we have really to its materiality, your Honor. The two years in question here are the fiscal years ended April 30, 1951, and April 30, 1952. There are several references to events and occurrences happening after the last date, after April 30, 1952.

There were also copies of minutes of directors' meetings and amendments to the articles and bylaws which occurred after April 30, 1952, and we submit, your Honor, that they are irrelevant and immaterial to the determination of whether this corporation was a tax-exempt institution during the fiscal years ended April 30, 1951, and April 30, 1952. [6]

The Court: That is just Paragraph XIV?

Mr. Wyshak: That would start, your Honor, on page 1 of the stipulation. The last two lines refer to that amendment to the articles on October 9, 1952. I submit that that should go out.

I further submit that since there is no issue here as to their being reasonable cause for filing returns late, Paragraph III should go out, since a refund is not claimed as to any penalty that might have been

paid in connection with the late filing of the return.

The Court: I will hear the evidence and make a determination as to the materiality.

Those are the only two paragraphs, that is, page 1, lines 31 and 32, and line 1 of page 2, and all Paragraph III?

Mr. Wyshak: All of Paragraph III, your Honor.

The Court: And all of Paragraph XVII?

Mr. Wyshak: Paragraph XIV, and all of the pages of the stipulation subsequent to page 43.

I believe that is the dividing line as to what took place before and after that date, starting with page 44 to the end of the stipulation.

In addition, pages 16 to 18 of the stipulation, your Honor. That is an amendment to the bylaws which took place after that date.

The Court: Well, you have covered that in your objection [7] to Paragraph XIV, that is, pages 10 to 18 and pages 44 to the end which you say are immaterial.

Mr. Wyshak: That is right, your Honor.

And also a minor matter, at line 8 of page 5——

Mr. Lewis: Of the stipulation?

Mr. Wyshak: Yes. I think we are interested in April 30, 1952, rather than April 30, 1953.

The Court: You object to that?

Mr. Wyshak: Yes.

The Court: Very well. Do you wish to be heard on his motion?

Mr. Lewis: Yes.

Mr. McHale and I worked out the stipulation of

facts and, I might say, that the decision to include all of the minutes and the amendments was his. He wanted to have the entire minutes in there.

I have this point concerning the relevancy or considering any facts subsequent to April 30, 1952. From the attitude of the Government in working on a stipulation of facts I received the impression that the good faith of the organizers of this Foundation might be in question, and I submit that if we are faced here with a question of whether or not they intended to form and operate in good faith a charitable corporation, that this court may look to what happened after April 30, 1952, in order to determine what their intent and what [8] their objectives were during the earlier two years.

As to the objection to the portions of the complaint and stipulation dealing with the reasonable cause, that is perfectly agreeable with me; it is not properly applicable and technically because we have not filed a claim for refund.

The Court: You mean that is Paragraph III?

Mr. Lewis: Paragraph III of the stipulation.

The Court: In other words, that is immaterial?

Mr. Wyshak: Yes.

Mr. Lewis: Yes, that is immaterial.

The Court: That may be stricken as immaterial.

Mr. Wyshak: You will notice an interlineation at line 23 of page 2, two words, "or materiality." That was added after Mr. Lewis signed the stipulation and he has agreed that that change may go in.

The Court: Very well.

Mr. Lewis: Mr. Randall.

PAUL M. RANDALL

called as a witness by and on behalf of the plaintiff, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name in full, please.

The Witness: Paul M. Randall.

The Clerk: And your address?

The Witness: 2050 Fremont Avenue, South Pasadena.

The Court: In connection with the objection to the [9] materiality and relevancy of the other matters, the objection is overruled. It would appear to me that the bona fides of the plaintiff are one of the factors that must be taken into consideration.

Proceed, counsel.

Direct Examination

By Mr. Lewis:

Q. Mr. Randall, will you state your business?

A. I am an investor and analyst.

Q. Do you have funds of your own invested in the market? A. Yes.

Q. For how long have you had a substantial amount of funds of your own invested in the market? A. Well, for the last 10 years.

Q. What has been the result of your investments?

A. Well, we have had very great appreciation.

Q. During the several years prior to 1950, what percentage of your income did you give to various

(Testimony of Paul M. Randall.)

charitable organizations? A. Before when?

Q. Before 1950.

A. About 10 per cent for the previous three or four years.

Q. Mr. Randall, were you instrumental in the organization [10] of the plaintiff foundation?

A. Yes.

Q. Were you the principal cause in its organization? A. Yes, I think I was.

Q. Why did you cause the plaintiff foundation to be formed?

A. Well, I had accumulated all the wealth that I intended to for my own personal use and I thought I should devote any ability that I might have as an investor and analyst to form this Foundation for charitable purposes.

Q. Did you have any specific charitable purpose in mind at the time?

A. I had been thinking for several years about something like Father Flanagan's Boys' Town.

Q. After the Foundation was formed who determined how its fund should be invested?

A. Our board of directors.

Q. And to whom did they give authority to invest the Foundation's funds?

A. They gave that to me.

Q. And pursuant to that authority did you cause the funds of the Foundation to be invested?

A. Yes.

Q. Securities to be bought and sold?

A. Yes. [11]

(Testimony of Paul M. Randall.)

Q. What reports were made to the board of directors of the Foundation concerning the investments? A. You mean at the end of the year?

Q. Both at the end of the year and during.

A. Well, from time to time we in our meetings would discuss what we had been doing.

Q. Were there any informal occasions when you discussed with the board the situation as to the investment of the Foundation's fund and the results that were being obtained? A. Oh, yes.

Q. About how frequently did that occur?

A. Oh, sometimes we would go three or four months without any discussion. Then it might be every month, or maybe twice a month.

Q. Mr. Randall, are you a broker?

A. No.

Q. Do you have any customers of your own at all? A. No.

Q. When securities of the Foundation were sold, to whom would they be sold?

A. They would be sold through a licensed broker on a stock exchange.

Q. Did you know the purchasers of the securities? A. No.

Q. When securities were purchased for the Foundation [12] would you know from whom they were purchased? A. No.

Q. How were they purchased?

A. Through a broker.

Q. It has been stipulated, Mr. Randall, that during the years ended April 30, 1951, and April 30,

(Testimony of Paul M. Randall.)

1952, there were quite a number of transactions involving the investment portfolio of the Foundation. In examining that stipulation you will find that on occasion the Foundation would buy in blocks of 100, maybe several blocks of 100, of the same security within a day or two, and they might sell in the same way. Can you explain why that happened?

A. Well, it probably was because of the thinness of the market. For instance, Universal Consolidated Oil, the market was very thin on that, and it was only a 100 share market with a point spread in between.

The Court: By "thin" you mean?

The Witness: There would be an order to buy, say, 100 at 63, and the next buying order might be a point and a half down, to 61½.

The Court: You mean the difference there was that there was not much margin in the price, that it varied?

The Witness: The size of the bid or offering was small. The size of the bid would be for only 100 shares, and if you had to sell 500, to sell that you could only sell 100 on that [13] particular day.

The Court: Is that what you mean by "thin"?

The Witness: Yes.

Q. (By Mr. Lewis): Why did you choose, if you were buying, say, 500 shares, to buy them in lots of 100 shares each rather than putting in an order for 500 shares at once?

A. Well, there are several reasons for that. You might be trading and an order for 500 shares, if it

(Testimony of Paul M. Randall.)

were shown on the floor of a stock exchange where the market was thin, you might not be able to complete your buying order, and you might just happen to be an opportunist in buying some of these stocks.

The Court: In other words, if you put in an order for 500 shares somebody might think you wanted it pretty bad and might raise the price?

The Witness: Yes, they would raise their bid.

Q. (By Mr. Lewis): What objective did you have in mind in determining what you should buy and what you should sell for the Foundation?

A. Would you repeat that?

Q. What objective did you have in mind in determining when the Foundation bought securities and when it sold them, and what securities it chose to buy and sell? What did you— [14] what did you have in mind in decisions in that respect?

A. Our main objective in buying securities was for appreciation.

Q. Did you have any other objective in mind in connection with the handling of the funds of the Foundation?

A. Well, to accumulate a fund large enough to do something worth while.

Q. This stipulation of fact also reveals, Mr. Randall, that during the early days of the Foundation's existence you loaned a total of $155,000 to the Foundation. How did it happen that those loans were made?

A. Well, there appeared to be an opportunity to

(Testimony of Paul M. Randall.)

accumulate this Universal Consolidated Oil, and the Foundation did not have enough of its own funds so in order to make this profit I made this loan to the Foundation.

Q. The stipulation also shows that the Foundation paid you 2½ per cent annual interest on your loans to the Foundation. How was that interest rate set?

A. Well, the call rate had fluctuated from 3¼ down to 2 per cent, I think, at the time that this loan was made, and I anticipated the average cost to me would be about 2½ per cent over an extended period, maybe a year or two or three years. So we arbitrarily set that rate of 2½ per cent.

Q. What compensation, if any, did you ever receive from the Foundation for your services to [15] it? A. None.

Q. Any compensation directly or indirectly from the Foundation? A. No.

Q. What benefit, if any, did you receive personally from your dealings with the Foundation?

A. Just the satisfaction of being successful in our operation.

Q. The stipulation also shows, Mr. Randall, that during the first year of the Foundation's existence you gave securities of an approximate value of $20,000 to the Foundation, whereas your gifts to the Foundation the second year totaled in value less than $1,000. Why did your gifts decline that second year?

A. Because we were having trouble securing our

(Testimony of Paul M. Randall.)

exemption from the Revenue Service, and because of the possible delay we didn't want to make any more donations until it had been cleared up.

The Court: Who were the original directors of this corporation—this is a California corporation?

The Witness: Yes.

Dr. Bailes, Mr. Flanagan, my son and my sister, Dorothy Ward.

The Court: Who is Dr. Bailes?

The Witness: Dr. Bailes—— [16]

Mr. Lewis: Your Honor, we have both Dr. Bailes and Mr. Flanagan here.

The Court: Are they any relation to you?

The Witness: No, sir.

The Court: And Mr. Flanagan?

The Witness: He was my attorney.

The Court: He is not related to you?

The Witness: No.

The Court: And then your son?

The Witness: Yes.

The Court: And your sister?

The Witness: Yes.

The Court: Have they remained as directors?

The Witness: No, they resigned. My son went in the service and resigned. My sister resigned also.

The Court: And that leaves the three of you, the original three?

The Witness: No, we have two new directors, a Mrs. May Gifford and a Mr. James Patterson.

The Court: And the original three?

The Witness: And the original three.

The Court: You, Dr. Bailes and Mr. Flanagan?

(Testimony of Paul M. Randall.)

The Witness: Yes.

The Court: Are these other two people related to you in any way? [17]

The Witness: No.

The Court: Very well.

Q. (By Mr. Lewis): Mr. Randall, the stipulation of facts shows that during the fiscal year ended April 30, 1951, the total expenses of the Foundation was $1,532.36. Do you have any recollection of what those expenses would be comprised of?

A. Well, I believe a part of it was interest and part of it was attorney's fees and part of it was accounting fees.

Q. Now the stipulation shows that during the second year those expenses increased from $1,532.36 to $8,271.99. The stipulation also shows that of that later figure, $8,271.99, that $3,639.45 consisted of interest which the Foundation paid on its loans?

A. Yes.

Q. Do you know what the other part of those expenses for the second year consisted of?

A. They were attorney's fees and accounting fees.

Q. And why were they substantially larger than they were the first year?

A. Well, so much work was being done on research and matters affecting the tax status of the Foundation.

Q. Will you tell the court what you have done on behalf of the Foundation with relation to its purpose of ultimately forming or having a part in

(Testimony of Paul M. Randall.)

a boys' home to which you [18] referred a moment ago?

Mr. Wyshak: I object to that as vague and indefinite.

Mr. Lewis: I will strike the question.

Q. You previously testified that one of the specific objections you had in mind when the Foundation was formed was the establishment of a boys' town similar to that of Father Flanagan in Nebraska. Can you state what steps, if any, the Foundation has taken in that direction?

Mr. Wyshak: I object to that also as vague and indefinite, without regard to when this objective was sought to be attained.

The Court: He cannot ask everything at once. He is asking what they did. I suppose his next question will be, when did you do it.

Q. (By Mr. Lewis): I think, Mr. Randall, it might be of assistance if you would try to state in chronological order the steps that have been taken, stating the first one first.

A. Well, during the first year we looked at various properties that might have been logically used for a boys' home. Property was looked at in Santa Barbara, or just outside of Santa Barbara. We looked at some property in Antelope Valley.

The second year we continued to look at various properties. [19]

Q. Do you recall the location of any properties you looked at during the second year?

A. We looked at a property in the San Fer-

(Testimony of Paul M. Randall.)

nando Valley that involved the expenditure of a lot of money if we had taken it on. We decided not to take it on.

Q. Subsequent to the second year did you look at any other property?

A. You mean the third year?

Q. Subsequent to April 30, 1952.

Mr. Wyshak: Your Honor, may we have a continuing objection on the basis of incompetence and irrelevance?

The Court: Yes. Overruled.

The Witness: We looked at various properties during the second year.

The Court: He means subsequent to that.

Q. (By Mr. Lewis): Subsequent to April 30, 1952.

A. Yes, I hired a Mr. Ramsdell to investigate some properties for me.

Q. Did you visit those properties with Mr. Ramsdell? A. Yes.

Q. Where were they located?

A. One was at Hot Springs down in San Diego County.

The Court: Did you buy any property?

The Witness: No, we never bought any property due to the [20] uncertainty of our tax status.

Q. (By Mr. Lewis): Has the Foundation ever made any detailed investigation of how the Father Flanagan Home operates? A. Yes.

Q. What was done in that connection?

(Testimony of Paul M. Randall.)

A. Mr. Ramsdell and myself went back to not only look at this Flanagan Boys' Home but he drew up a report covering our trip.

Q. Who is Mr. Ramsdell?

A. Mr. Ramsdell is an attorney who was formerly employed by the Los Angeles City Schools as a—I think he had something to do with delinquent children.

Mr. Lewis: I have no further questions.

The Court: Cross-examine.

We might take a short recess. I have a phone call to make.

(Short recess.)

The Court: Proceed.

Cross-Examination

By Mr. Wyshak:

Q. During the years in question, Mr. Randall, where was your Universal Consolidated Oil listed, it at all?

A. In Los Angeles and San Francisco and New York.

The Court: On the New York Stock Exchange or the [21] so-called—what did they call it, the American?

The Witness: It is the American Exchange, formerly the Curb Exchange.

Q. (By Mr. Wyshak): It was listed on the American, the Los Angeles and San Francisco Ex-

(Testimony of Paul M. Randall.)

changes? A. That is right.

Q. Do you know what a specialist is, Mr. Randall? A. Yes.

Q. Is it not true that every stock that is listed on an exchange has a specialist in that stock?

A. Yes.

Q. How would you define the duties of a specialist?

A. Well, his duty is to attempt to keep an orderly market in a stock, but in many cases they are not able to do so.

Q. In other words, stabilize the market so that when there is a wide range between the bid and the ask, to narrow it? A. That is right.

Q. Do you know if there was a specialist in Universal Consolidated Oil in the years in question?

A. I am sure there was.

Q. Yet you took it upon yourself to be a specialist and stabilize the market in that stock? [22]

A. No, I don't believe I attempted to do anything like that. I just attempted to accumulate when it was advantageous for us to do so, and sell when I thought it was advantageous to do so.

Q. In other words, in those cases where you bought this stock on one day and two days later sold it, it was usually at a small profit, was it not?

A. Yes.

Q. In other words, you wouldn't sell it at a loss merely to stabilize the market? A. No.

Q. Did anyone else or has anyone else contributed any money or property to this Foundation

(Testimony of Paul M. Randall.)

since its formation? A. No.

Q. Do you recall the names of the companies whose securities you gave to the Foundation at its formation? Just generally can you recall most of them? A. I think so.

Q. At the time they were contributed to the Foundation, did you have a profit on those stocks?

A. Yes.

Q. On all of them? A. I believe I did.

Q. Would you call it a substantial profit?

A. Yes. I believe it was. [23]

Q. And what did the Foundation do with those securities after you contributed them to it?

A. I believe in almost every case they sold them.

Q. How soon after the contribution to the Foundation?

A. In almost every instance I believe it was immediately.

Q. Immediately? A. Yes.

Q. The same day or the next day?

A. Yes.

Q. Has the corporation paid a tax resulting from the sale of those securities?

A. Well, it has filed a return for the first two years, I believe.

Q. But was any tax paid as the result of the sale of those particular securities that were contributed to the Foundation?

The Court: We have not established that there was any profit made.

(Testimony of Paul M. Randall.)

The Witness: What kind of tax do you mean?

Q. (By Mr. Wyshak): Was there any profit made on the sale of those securities?

The Court: Was there any gain, you mean? [24]

Q. (By Mr. Wyshak): Which would be taxable. A. No, I don't believe there was.

The Court: Was there any gain at all?

The Witness: To the Foundation?

The Court: Yes.

The Witness: If the Foundation received the stocks one day and sold them the next, I mean what would be their base?

Q. (By Mr. Wyshak): Do you know if any gain was reported and any tax paid on that gain?

A. I don't believe there was.

The Court: By the corporation?

Mr. Wyshak: By the corporation.

The Witness: I don't believe there was, no.

The Court: That is the answer to both of his questions, that there was no gain and no gain reported and no tax paid.

The Witness: Yes.

Mr. Wyshak: I believe the stipulation shows, Your Honor, that the first loan to the Foundation by Mr. Randall was in the sum of $40,000.

The Court: The first what?

Mr. Wyshak: The first loan by Mr. Randall was $40,000. That is at page 4, line 29, of the stipulation. It was in the amount of $40,000 on May 29, 1951. [25]

(Testimony of Paul M. Randall.)

Q. What was the source of that loan, Mr. Randall?

A. You mean where did I get the $40,000?

Q. That is right.

A. I borrowed that from my broker.

Mr. Lewis: May I interrupt? I think your date is wrong.

Mr. Wyshak: May 29—no, that is the repayment. It is June 13, 1951. I am sorry, Your Honor.

Q. Is that broker Akin-Lambert Company?

A. Yes.

Mr. Wyshak: May I have this marked for identification?

The Court: That was a cash loan?

The Witness: Yes.

Mr. Wyshak: Well, presumably they gave it to him in check form.

The Court: A check is cash.

The Clerk: Defendant's A for Identification.

(The document referred to was marked Defendant's Exhibit A for Identification.)

Q. (By Mr. Wyshak): Do you recognize this June 19, 1950, statement from Akin-Lambert in the name of Paul M. Randall? A. Yes.

Q. Would you say that this item showing a debit in the amount of $40,000 on June 13, 1950, was the sum which was [26] loaned to the Foundation?

A. It looks like it.

Q. And what was the interest rate that was being paid on that sum that was loaned?

(Testimony of Paul M. Randall.)

A. 2 per cent.

Q. And what was the interest rate which the Foundation paid you as a result of this loan?

A. The interest that the Foundation eventually paid me was 2½ per cent.

Mr. Wyshak: May I have this placed in evidence?

The Court: Defendant's A in evidence.

(The document referred to was marked Defendant's Exhibit A and received in evidence.)

IN ACCOUNT WITH
AKIN - LAMBERT CO., INC.
635 SOUTH SPRING STREET
LOS ANGELES 14, CALIF.
VANDIKE 1071

A

PAUL M RANDALL
2859 FREMONT AVE
SOUTH PASADENA CALIF

QUANTITY BOUGHT OR RECEIVED	QUANTITY SOLD OR DELIVERED	DESCRIPTION	EXPLANATION	PRICE	DEBITS	CREDITS	BALANCE
						BALANCE FORWARD	152,028.69
00		BANDINI PETE					
500		BARNHART & MORROW CONS					
00		BADIN OIL					
000		BISHOP OIL CO					
00		CALAVERAS CEMENT COMM					
00		HANCOCK OIL A					
00		OCEANIC OIL					
400		SIGNAL OIL & GAS A					
63		SIGNAL OIL & GAS B					
000		UNIVERSAL CONS OIL					
		DIV 600 HANCOCK OIL A		JV		450.00	151,578.69
		DR CK			40,000.00		191,578.69
		DIV 2200 SIGNAL OIL & GAS A		JV		550.00	
		DIV 173 SIGNAL OIL & GAS B		JV		43.25	190,985.44
	300.	CALAVERAS CEMENT COMM		18 50		5,477.13	185,508.31
		DIV 1500 BISHOP OIL		JV		37.50	185,470.81
		INTEREST 2%			285.65		185,756.46
		HANCOCK OIL		JV			
		DIV 600 HANCOCK OIL		JV		600.00	185,156.46

E. & O. E.

IMPORTANT—Save for Income Tax Purposes

These statements constitute a complete record of your transactions. It is very important that you have them at the end of the year for income tax purposes. We are always ready to answer special questions, but it would be obviously impossible to make transcripts of accounts at the end of the year.

PLEASE EXAMINE AND RETURN IMMEDIATELY IF NOT CORRECT

IN ACCOUNT WITH
AKIN - LAMBERT CO., INC.
639 SOUTH SPRING STREET
LOS ANGELES 14, CALIF.
VANDIKE 1071

PAUL W RANDALL
2050 FREMONT AVE
SOUTH PASADENA CALIF

QUANTITY BOUGHT OR RECEIVED	QUANTITY SOLD OR DELIVERED	DESCRIPTION	EXPLANATION	PRICE	DEBITS	CREDITS	BALANCE
LONG						BALANCE FORWARD	152,028.69
	4200	BANDINI PETE					
1520	700	BARNHART & MORROW CONS					
300	3,900	BABIN OIL					
1600	28,800	BISHOP OIL CO					
400	1800	CALAVERAS CEMENT COMM					
800	72,000	HANCOCK OIL A					
700	1,500	OCEANIC OIL					
2400	132,000	SIGNAL OIL & GAS A					
185	16,000	SIGNAL OIL & GAS B					
2000	132,600	UNIVERSAL CONS OIL					
	379,800						
	119,600						
	154,000						
	37,600						

Case No. 16142 PH
Randall vs. Diegel
Defts EXHIBIT A
Date OCT 11 1954 No. A IDENTIFICATION
Date OCT 11 1954 No. A IN EVIDENCE
Clerk, U. S. District Court, Sou. Dist. of Calif.
Deputy Clerk

E. & O. E.

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(Testimony of Paul M. Randall.)

Q. (By Mr. Wyshak): And this loan was not repaid to you until May 29, 1951?

A. I believe that was the time.

Q. And you received interest at the rate of 2½ per cent all during that time from the Foundation?

A. Yes.

The Court: There are a lot of penciled figures on this exhibit.

Mr. Wyshak: I don't know whose they are. They might be Mr. Randall's, they might be somebody else's.

Mr. Lewis: I am sorry, I don't know, Your Honor. [27]

The Court: I will disregard them.

Mr. Lewis: Yes.

Mr. Wyshak: Very well.

Q. Who were the brokers through whom orders were executed on behalf of the Foundation?

A. Akin-Lambert and Harbison & Henderson.

Q. Did you use those same two brokers on your personal account? A. Yes, I did.

Q. Did you use the same customer's man in those firms for the Foundation's account as your own personal account? A. Yes.

Q. At the time the Foundation was organized and shortly thereafter, did you intend to build a boys' home with the capital that was available to the Foundation?

A. That was one of the outstanding things that I wanted to do, and still do.

(Testimony of Paul M. Randall.)

Q. You didn't feel during that first year that you had sufficient capital to set up the boys' home, did you?

A. No, sir. It was my objective to build up a fund large enough so that we could be secure in perpetuating it when we actually did start it.

Q. What did you consider a sufficient fund at that time?

A. We felt that a quarter of a million dollars would be enough possibly to get started. [28]

Q. Approximately what was the market value of the date of contribution of those shares of stock which were contributed to the Foundation by you during 1951 and '52?

Mr. Lewis: Your Honor please, those facts are all stipulated to.

The Court: Yes, they are stipulated to.

Q. (By Mr. Wyshak): Were notes ever executed to you by the Foundation? A. Yes.

Q. Do you have those notes with you?

A. No.

Q. How many notes were issued, do you have any idea?

A. There were eight or nine or ten. I have the records at home on it. I don't remember.

The Court: Do you have the notes?

The Witness: No. When the notes were paid. I believe shortly after they were destroyed.

The Court: Did you execute notes to the brokerage houses from whom you borrowed the money or borrowed on your margin account?

(Testimony of Paul M. Randall.)

The Witness: I borrowed on my margin account.

Q. (By Mr. Wyshak): Margin accounts were opened in both of these broker's houses on behalf of the Foundation, were they not?

A. Yes. [29]

Q. Were the securities that were purchased and sold on behalf of the corporation comparable to the securities that were purchased and sold at the respective periods by yourself?

A. Will you say that again, please?

Q. Were the stocks that were bought and sold on behalf of the Foundation the same stocks that you were buying and selling on your own account?

A. Yes.

Q. After the Foundation was organized, did you do any less trading in your own account than you had before the corporation was organized?

A. Yes, I believe I did a lot less business on my own account after the Foundation was organized.

Q. In other words, most of your activity was directed to trading on behalf of the Foundation?

A. Yes.

Q. Did you ever put up any collateral for the Foundation on its margin accounts with either of those two houses?

A. Yes, I believe there is one time that we did put up some Universal Consolidated Oil as margin for the Foundation's account.

Q. Were transfer taxes paid on the putting up of the collateral on the Foundation's account?

A. I don't know. [30]

(Testimony of Paul M. Randall.)

Q. At the time you contributed the shares of stock which were set forth in the stipulation to the foundation originally were transfer taxes paid on those transfers?

A. I wouldn't know about that, either.

Q. Well, in whose name were the shares of stock which you contributed to the Foundation?

A. They were in my name.

Q. A loan? A. I believe so.

Q. In whose name were they sold?

A. In the name of the Foundation.

Q. But you don't know if transfer taxes were paid on the transfer from you to the Foundation?

A. No. I believe that is always left up to the broker. If he thinks there is a tax due, I think he pays it.

Q. Would you describe most of the oil securities in which trading took place on behalf of the Foundation as speculative securities?

A. Some of them were. You might consider some of them were quite speculative.

Q. Your aim then was to build up the capital of the Foundation by speculating in these securities, thereby securing the profit to build up a quarter of a million dollars capital with which to build a boys' home, is that correct?

A. Well, I mean it is hard to describe, or it is hard [31] to draw a distinction between a speculative stock and——

The Court: He is now asking you if your pur-

(Testimony of Paul M. Randall.)

pose was to build up a capital of $250,000 with which to build a boys' home.

The Witness: Yes, that is right.

Q. (By Mr. Wyshak): And you wanted to do that with approximately $20,000 capital?

A. Well, I loaned the Foundation $150,000 in addition to my contributions.

Q. But you fully expected to get that back, didn't you? A. My loan, yes.

Q. So that the only capital of the Foundation was the $21,000 that was contributed by you?

A. That is right.

Q. No tax was ever paid on the profit that existed from the time you bought those securities which you contributed to the Foundation and which were sold by the Foundation?

The Court: That is covered by the stipulation, counsel.

Mr. Wyshak: I don't believe it is, your Honor.

The Court: The stipulation says that they filed a return and paid the tax.

Mr. Wyshak: I am talking about that particular group of stocks which he contributed to the Foundation and which [32] the Foundation sold the next day or the same day he contributed it.

The Court: That has been asked and answered.

Mr. Wyshak: I am saying that no tax was paid by him or the Foundation. I believe we only covered the Foundation.

Mr. Lewis: Your Honor, as I remember the answer to the question, the witness didn't know.

(Testimony of Paul M. Randall.)

I am perfectly willing to have him ask if he paid any tax on the appreciation of the securities between what he paid for them and what they were worth when he gave them to the Foundation.

The Court: Between the time he got them and the time he gave them to the Foundation?

Mr. Lewis: Yes. I don't think that question has been answered.

The Court: Very well.

Q. (By Mr. Wyshak): Between the time you bought those stocks and they were sold by the Foundation, was any tax paid by you on the profit?

A. No.

Q. Was any tax paid by the Foundation on that profit?

Mr. Lewis: I think the witness has previously answered that question. He said he didn't know.

The Court: He said there was no gain and no return. [33] They were given to them one day and sold by the Foundation the next.

Who made the determination for the gifts which are set out in the stipulation totaling $11,600, $3,600 of which were in '51 and $10,100 in '52? Who made the determination as to who should be the recipient of these sums?

The Witness: I did.

The Court: Did you or the board of trustees? Did you consult with them?

The Witness: Yes, they knew about it. I discussed in advance that I was going to do that.

The Court: And did they approve it?

(Testimony of Paul M. Randall.)

The Witness: Yes.

The Court: Are there any minutes here as to that?

Mr. Lewis: Oh, yes, your Honor. There are adequate minutes.

The Court: Very well. Go ahead, counsel.

Q. (By Mr. Wyshak): If you intended to accumulate a quarter of a million dollars for a boys' home, why did you bother giving any charity any sum of money?

A. Well, we discussed it with the board of directors and they decided that it would probably be good if we did.

Q. They didn't feel that it might help you get a tax-exempt status for this Foundation? [34]

A. That might have had something to do with it.

Q. There is in the bylaws or in the articles nothing preventing a gift of any profit realized from security transactions to one of these charities, is there? A. Will you say that again?

Q. There is nothing in the articles or bylaws preventing a gift of part of the profit from security transactions to one of the charities to which money was given?

A. No. That is left to the discretion of the board of directors, I believe.

Q. Was any charitable activity other than those gifts that are set forth in the stipulation pursued during the fiscal years ended April 30, 1951, and April 30, 1952?

A. By the Foundation—I don't believe so.

(Testimony of Paul M. Randall.)

Q. By the Foundation?

A. I don't believe so.

Mr. Wyshak: That is all.

The Court: Redirect?

Mr. Lewis: Yes, your Honor.

Redirect Examination

By Mr. Lewis:

Q. Mr. Randall, you mentioned that some of the securities which the Foundation purchased might be considered speculative. What securities did you have in mind as falling in that category? [35]

A. Well, maybe Universal Consolidated Oil or maybe Bishop.

Q. In what sense were they speculative?

A. Well, it is very hard to draw a line between a speculative stock and an investment stock.

Q. Will you tell the court what you mean by speculative in respect to those two securities?

A. I expected that there would be a great appreciation in the price within several years.

The Court: Was there a difference between buying a stock that is speculative or—let me put it this way—can a stock still be safe and be speculative?

The Witness: Yes.

The Court: As, for instance, an oil stock?

The Witness: Yes.

The Court: In other words, if you know of some possible venture into a new field that the company is drilling, their stock would be a safe buy in your

(Testimony of Paul M. Randall.)

opinion, but at the time it would be speculative because it might go up?

The Witness: That is right.

The Court: For instance, if they hit it as Richfield did in Cuyama?

The Witness: That is right.

Q. (By Mr. Lewis): Is that what you mean by describing those stocks [36] as speculative?

A. That is right.

Q. Mr. Randall, under the stipulation it appears that during the first year of the Foundation you gave it securities of approximately the market value of $20,000, and during the subsequent year you gave it less than $1,000.

When you formed the Foundation what was your intention as to the amount of your annual gifts to it?

Mr. Wyshak: I object to that question as hearsay and immaterial.

Mr. Lewis: Your Honor, it has a direct bearing on the question put by counsel as to how he expected to raise the money for the boys' home.

The Court: Overruled.

The Witness: I intended to contribute at least 10 per cent of my income to my own Foundation along with another 10 per cent to other charities.

Q. (By Mr. Lewis): Why didn't you give that much the second year?

A. Because of the uncertainty of our tax status.

Mr. Wyshak: I move to strike those answers on the ground that he didn't——

(Testimony of Paul M. Randall.)

The Court: I think it is self-serving, but I think it is proper redirect because on your cross you went into his state of mind at the time he organized and what he intended [37] to do and how he hoped to do it. The motion to strike is denied.

Mr. Lewis: That is all.

Mr. Wyshak: Just one question.

Recross-Examination

By Mr. Wyshak:

Q. I believe one of the first questions that Mr. Lewis asked you was what your occupation was, and you said investor and something else?

The Court: Analyst.

Q. (By Mr. Wyshak): And analyst. Do you consider yourself a trader?

A. Well, no, I don't believe so. I am more of an investor. I work on special situations.

Mr. Wyshak: May I have this 1950 Federal income tax return marked for identification?

The Court: That is the witness' personal return?

Mr. Wyshak: His personal 1950 Federal income tax return.

The Clerk: It will be Exhibit B.

(The tax return referred to was marked Defendant's Exhibit B for identification.)

Q. (By Mr. Wyshak): Do you recognize your signature, Mr. Randall, on this Form 1040 for the year 1950? A. Yes. [38]

(Testimony of Paul M. Randall.)

Q. And what is your occupation as there set forth?

A. It is stated there as trader and investor. And if I can qualify that answer about not being a trader, that is something that is rather hard to define, too. You may be an investor in special situations and——

Q. But at that time you did consider yourself a trader?

A. Well, you might say so. But it is, as I say, hard to make a distinction.

Q. Have you ever heard yourself described by any broker as a good trader? A. No.

Mr. Wyshak: That is all.

The Court: Step down.

(Witness excused.)

The Court: Next witness.

Mr. Lewis: Dr. Bailes.

FREDERICK BAILES

called as a witness by and on behalf of the plaintiff, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name in full, please.

The Witness: Frederick Bailes, B-a-i-l-e-s.

The Clerk: And your address?

The Witness: 846 South Sycamore Avenue, Los Angeles. [39]

(Testimony of Frederick Bailes.)

Direct Examination

By Mr. Lewis:

Q. Dr. Bailes, what is your profession?

A. I am a minister of a religion.

Q. What is your church?

A. Science of Mind Church.

Q. Are you presently a minister of that church?

A. Yes.

Q. For how long have you been minister?

A. Seventeen years.

Q. How many members do you now have in your congregation?

A. About a month ago it was touching 2,000.

Q. How long have you known the preceding witness, Mr. Randall?

A. Probably since about 1940, into 14 years.

Q. What has been the nature of your relationship during that time?

A. Well, I have gone under his guidance very largely in the use of my own money.

Q. In investing your money?

A. Investing my own money.

Q. What have you found the results of his advice are?

A. Very excellent as far as I am concerned.

Q. Did he ask you to serve as a director on the Randall [40] Foundation when it was organized?

A. Yes.

Q. And have you been a director of that Foun-

(Testimony of Frederick Bailes.)

dation ever since? A. Yes.

Q. When he asked you to serve on it, why did you consent to serve as a director?

A. Well, we had talked many times in the years preceding its foundation and he had been telling of his desire to really do something for other people, and we discussed various types of organizations, and when he said he was going to set up this Foundation now, that he was about getting into position to be able to do it, I thought it would be an excellent thing because of the purpose he had in taking young fellows that probably hadn't had a chance and surrounding them with the proper environment.

Q. Did he mention that purpose to you at the time he discussed your being a director?

A. Yes.

Q. Since you have been a director who has determined how the funds of the Foundation should be directed? A. The board.

Q. And to whom have you delegated that authority? A. To Mr. Randall.

Q. And it is stipulated here that during the [41] first year and a half of the Foundation's existence Mr. Randall loaned considerable funds of his personal funds to the Foundation. Do you have knowledge of those loans? A. Yes.

Q. By what authority did the Foundation pay Mr. Randall interest on those loans?

A. Well, discussions resulting in authorization of him to make the loan at a particular rate.

(Testimony of Frederick Bailes.)

Mr. Wyshak: Your Honor, this is all in the minutes.

Mr. Lewis: Very well.

Q. During the time that you have been a director, how frequently have you discussed the Foundation's affairs with Mr. Randall?

A. Well, at the stated meetings, but then at a great many other meetings, what you might call informal meetings.

Q. And what was discussed on those occasions?

A. Practically everything that was going on in the corporation as well as the plans, future plans. Also I drove out with Mr. Randall to look at properties from time to time.

Q. Do you know whether audited reports of the Foundation's condition were made each year?

A. Yes.

Q. Did you receive a copy of that auditing report? A. Yes.

Q. Do you recall ever having discussed with the board [42] the advisability of the Foundation making gifts to various charities? A. Yes.

Q. Were designations made at that time concerning gifts? A. Yes.

Mr. Lewis: I have no further questions.

The Court: Cross-examine.

Cross-Examination

By Mr. Wyshak:

Q. You didn't contribute any funds to the Foundation, Dr. Bailes? A. No, sir.

(Testimony of Frederick Bailes.)

Q. Were funds solicited by or from others by any of the other directors?

A. No, not up until this date.

Mr. Wyshak: No more questions.

The Court: Step down.

(Witness excused.)

The Court: Next witness.

Mr. Lewis: Mr. Flanagan.

JAMES A. FLANAGAN

called as a witness by and on behalf of the plaintiff, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name in full, please? [43]

The Witness: James A. Flanagan.

The Clerk: Will you spell your last name?

The Witness: F-l-a-n-a-g-a-n.

The Clerk: And your address?

The Witness: 153 South Camden, Beverly Hills.

Direct Examination

By Mr. Lewis:

Q. Mr. Flanagan, what is your business?

A. I am an attorney.

Q. How long have you been a member of the California bar? A. Approximately 25 years.

Q. How long have you known Mr. Randall?

A. About seven or eight years.

Q. Were you his attorney in the spring of 1950?

(Testimony of James A. Flanagan.)

A. Yes.

Q. In that capacity did he consult you concerning the formation of the Randall Foundation?

A. He did.

Q. Did you draw articles of incorporation for that Foundation? A. Yes.

Q. Do you recall at that time discussing whether or not the charitable objectives of the Foundation should be specifically set forth in those articles? [44]

A. Well, he told me——

Mr. Wyshak: Just a moment. I object to that. He can answer yes or no.

The Court: I think it can be answered yes or no.

The Witness: Yes.

Q. (By Mr. Lewis): Will you explain what happened on that occasion?

A. Well, Mr. Randall told me that he wanted to eventually create a foundation similar to Boys' Town in Nebraska, and that it might take a little while before enough funds were accumulated for that purpose, but that was what he primarily wanted to accomplish, and when we came to draw up the articles I stated in general terms "charitable purposes," and Mr. Randall asked me something about stating a primary term, and I told him I didn't feel it was necessary under the California law at that time.

Q. Were you a director for a good part of the life of this Foundation? A. Yes, I was.

Q. Do you recall——

The Court: Are you now?

(Testimony of James A. Flanagan.)

The Witness: I am now.

The Court: In other words, you have been ever since it started?

The Witness: Well, there was a short period—I signed [45] as a director when the organization was first formed, and after the formation I resigned to give Mr. Randall and the Board a chance to choose somebody else if they wanted to, and they wanted me to go back on, and I did.

Mr. Lewis: The stipulation will show that in November, 1951, he was returned to the board of directors.

The Court: Very well.

Q. (By Mr. Lewis): As a director, do you recall in any of the directors' meetings any discussion as to whether or not the Foundation should make any gifts to charitable organizations? A. Yes.

Q. Can you tell us the substance of those discussions?

A. Well, we discussed the advisability of making contributions to various charities. Mr. Randall wanted to accumulate funds and was perhaps not as much inclined to make contributions as some of the rest of us, but we felt that perhaps some should be made along the line and, as I recall on several occasions, the board's trustees voted to make contributions.

Q. It has been stipulated, Mr. Flanagan, that in the fall of 1952 an amendment to the bylaws of the Foundation were made which required it to either build or inaugurate a boys' home which would

(Testimony of James A. Flanagan.)

house at least 50 boys by December, 1957. Do you recall drawing that amendment? [46]

A. Yes.

Mr. Wyshak: I object, your Honor, on the ground it is immaterial and irrelevant.

The Court: Overruled.

Q. (By Mr. Lewis): Was there an attempt made at that time to amend the articles in a similar fashion? A. Yes, there was.

Q. And what was the result of that attempt?

A. Well, as I remember, we attempted to amend the articles to provide that if we did not have established by a certain date—I believe 1957 or thereabouts—a boys' home caring for at least 50 boys that the board of directors——

The Court: December, 1959?

The Witness: December, 1959—that the board of directors would dissolve the corporation.

The State refused to let us file in that form because of the fact that there could not be a mandatory provision in regard to dissolution, that it had to be a voluntary act of the board of directors, and therefore we did amend the bylaws to make some provision for it.

Q. (By Mr. Lewis): Do you recall what caused you to make that amendment to the bylaws——

Mr. Wyshak: Same objection, your Honor. [47]

The Court: Overruled.

The Witness: A firm was employed in Washington, D. C., to take up this matter of exemption with

(Testimony of James A. Flanagan.)

the Department and that firm advised me that the Department wanted an amendment.

Mr. Wyshak: Objection to this portion of his testimony on the ground that it is hearsay and incompetent.

The Court: Overruled.

The Witness: That firm advised me that the Department wanted us to amend the articles to set up our primary purpose, and since our primary purpose was to establish a boys' home they wanted us to set that forth, and further provide that we would do so, would establish this home by a fixed date.

Q. (By Mr. Lewis): While you were a director of the plaintiff Foundation, how often did you discuss its affairs with Mr. Randall?

A. I would say I discussed the affairs with him on the average of once a week, a good part of the time.

Q. What did those discussions cover?

A. Well, various proposed investments and possibility of locations for a boys' home, purchase of locations and contributions—various things of that kind.

Mr. Lewis: I have no further questions.

The Court: Cross-examine. [48]

(Testimony of James A. Flanagan.)

Cross-Examination

By Mr. Wyshak:

Q. I believe you stated, Mr. Flanagan, that in your conversations with Mr. Randall he indicated to you that he wanted to accumulate funds so that he could build a boys' home, is that correct?

A. That is right.

Q. Did he tell you how he intended to accumulate those funds?

A. He said he intended to make contributions to the Foundation when formed and through investment to secure additional funds which he thought eventually would lead to such an accumulation.

Q. Did he ever give you any indication of what he meant by "eventually"?

A. I think he thought it would take several years, two to four years or thereabouts.

Q. And during that time the only source of funds was to be any contributions he might make and any profits realized from speculating in the stock market?

A. No, I think that we all on the board hoped to make some contributions during the course of the Foundation, and I think that we hoped to secure contributions from other people.

Q. I don't believe you have answered the question, Mr. Flanagan. [49] Would you read it again, Mr. Reporter?

(The question referred to was read by the reporter as follows: "Q. And during that time

(Testimony of James A. Flanagan.)

the only source of funds was to be any contributions he might make and any profits realized from speculating in the stock market?")

The Witness: That was not the only source of funds contemplated.

Q. (By Mr. Wyshak): You at no time did contribute any funds, though, did you?

A. No, not after the Government raised a question. All contributions were set aside.

Q. I believe you stated you became a director in November, 1951?

A. I was a director after having resigned once.

Q. Shortly thereafter the Commissioner of Internal Revenue ruled for the second time that this Foundation was not tax exempt, isn't that correct?

A. Possibly it did. I don't remember the dates.

Q. Approximately how many times would you say you met, the board of directors and Mr. Randall, between the time of your re-election on the board of directors on April 30, 1952?

A. How many times did I meet with Mr. Randall and the [50] board?

Q. Yes.

A. Oh, I would guess 15 times or thereabouts, maybe more.

Q. Out of that 15 times how many discussions took place with regard to making contributions to charity?

A. Well, I would say four or five. I think that there were several occasions, as I recall, that we voted contributions to different charities.

(Testimony of James A. Flanagan.)

Q. Would you say that that four or five times was scattered throughout the 15 different meetings or was it nearer the beginning of that period or the end of the period or the middle of it?

A. I would say it was scattered.

Q. Yet according to the stipulation, no money was contributed at any time between your re-election and the end of the fiscal year, is that correct?

A. That is between November, 1950——

Q. 1951—or is it '50 or '51 that you were re-elected?

A. I think it was '50. I may be wrong.

Mr. Lewis: The stipulation shows, Your Honor, that the Foundation was formed in May of 1950 and Mr. Flanagan was re-elected to the board in November.

The Court: 1951 you said a while ago.

Mr. Lewis: May I check that? [51] November, 1951, is correct, Your Honor.

The Court: Very well.

Mr. Wyshak: Will you read the last question and answer, Mr. Reporter?

(The record referred to was read by the reporter as follows:)

"Q. Yet according to the stipulation, no money was contributed at any time between your re-election and the end of the fiscal year, is that correct?

"A. That is between November, 1950——

"Q. 1951—or is it '50 or '51 that you were re-elected?

(Testimony of James A. Flanagan.)

"A. I think it was '50. I may be wrong.

"Mr. Lewis: The stipulation shows, Your Honor, that the Foundation was formed in May of 1950 and Mr. Flanagan was re-elected to the board in November."

Mr. Lewis: That is a misstatement of the stipulation.

The Court: Whatever the stipulation shows, it shows, and that is the answer.

The Witness: I would say there was but I don't remember.

The Court: He is asking you what the stipulation shows. It speaks for itself.

Mr. Wyshak: No further questions.

The Court: Step down. [52]

Mr. Lewis: I have one further question.

Redirect Examination

By Mr. Lewis:

Q. You mentioned, Mr. Flanagan, that you had approximately 15 meetings, as I recall. Were those all formal directors' meetings or were some informal meetings, just to clarify the record?

A. I think some were informal meetings but we did have quite a few directors' meetings.

Mr. Lewis: That is all.

Mr. Wyshak: That is all.

The Court: Step down.

(Witness excused.)

The Court: Is that all of the witnesses?

Mr. Lewis: That is all our witnesses.

The Court: Are there any Government witnesses?

Mr. Wyshak: I have Mr. Reed here.

The Court: Does the plaintiff rest?

Mr. Lewis: Yes, Your Honor.

EDWIN L. REED

called as a witness by and on behalf of the defendant, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name in full, please.

The Witness: Edwin L. Reed, R-e-e-d.

The Clerk: And your address? [53]

The Witness: 115 South Los Robles, Pasadena.

(Conference between counsel.)

Mr. Wyshak: Your Honor, perhaps we had better take a recess if you so intended to.

The Court: I have an appointment at 4:00 o'clock.

Mr. Wyshak: This is only going to take five minutes once we get started.

The Court: What are you going to do, stipulate to a lot of records?

Mr. Lewis: The difficulty, Your Honor, is this——

The Court: What is your business? Are you a revenue agent?

The Witness: I am a revenue agent.

The Court: What are you going to prove by him, counsel?

(Testimony of Edwin L. Reed.)

Mr. Wyshak: I am merely asking him to show the number of shares of stock that were purchased in these fiscal years by the corporation, and I am seeking a stipulation that those brokerage statements, which were procured from the plaintiff, are the only brokerage statements for those years for the Foundation.

Mr. Lewis: I will so stipulate.

The thing that is a little bit bothersome to me, Your Honor, is that Mr. McHale, the other gentleman from the United States Attorney's office, worked out our stipulation with the thought that we would save some time. It seems that [54] this is just cumulative.

The Court: What are Schedules E and F? Are they here?

Mr. Lewis: You will find on the stipulation——

The Court: I know, but you talk about E and F. But what is E and what is F?

Mr. Wyshak: Those only show the number of sales by the corporation during those years, Your Honor, and I wanted to show the number of purchases. We could only do that by means of these brokerage statements, since the purchases wouldn't show up unless they were also sold within that period.

Mr. Lewis: Your Honor, we discussed the matter, Mr. McHale and I and we had this problem, that on a brokerage statement it might show that there were 100 shares purchased, another 100 shares purchased, but we went to the brokerage houses

(Testimony of Edwin L. Reed.)

and we could find no record as to whether or not that was in response to one order to purchase 300 shares, and therefore in view of that language as to what this means, Mr. McHale and I decided to stipulate in the manner we have done and we thought that that would give the Court enough information concerning the activities here involved.

The Court: Is not the Government foreclosed from this by virtue of your stipulation?

Mr. Lewis: No, the stiplation does not say it is inclusive, Your Honor, but I have no objection to introducing those in evidence, but with the understanding that though that might record three different purchases it doesn't mean [55] that there were that many.

The Court: What did you want to show by this witness?

Mr. Wyshak: I am not trying to show the number of transactions, I am trying to show the number of shares of stock traded. Mr. Lewis is correct in that regard, that you can't tell whether a certain enumeration meant there were that many or not.

The Court: Does not this Schedule E and F attached to the complaint show the number of shares of stock that were traded?

Mr. Wyshak: No, it merely shows the number that were sold during that period. In other words, E and F show any gain or loss on any sales, but it doesn't show the purchases.

The Court: What is the difference what the purchases were?

(Testimony of Edwin L. Reed.)

Mr. Wyshak: I am trying to show how many shares of stock were purchased and how many were sold in this period to show the volume of trading that took place.

Mr. Lewis: Your Honor, may I suggest this, I have no objection to stipulating that they may be admitted——

Mr. Wyshak: I don't want to introduce them into evidence, I just want to have the agent say that he examined these and added up all the purchases and they come to so much.

The Court: Let them be marked for identification as Defendant's Exhibit C. [56]

(The document referred to was marked Defendant's Exhibit C for Identification.)

The Court: Mr. Reed, have you gone through those statements?

The Witness: I have, Your Honor.

The Court: And it is stipulated that they were secured from the plaintiff?

Mr. Lewis: Yes.

The Court: And have you made a tabulation of the total number of shares purchased?

The Witness: Yes.

The Court: And the dates?

The Witness: Yes, sir.

The Court: And the names of the companies and the amounts paid?

The Witness: Not the amount.

The Court: You have that in written form?

(Testimony of Edwin L. Reed.)

The Witness: I have.

The Court: Show it to counsel.

(Exhibiting document to counsel.)

The Court: Is that all you wanted to prove with this witness?

Mr. Wyshak: And also he has a total of the number of shares on E and F. I thought it might aid Your Honor.

Mr. Lewis: What is your thought, counsel, that you are [57] going to use just the first page or all the pages of this?

Mr. Wyshak: I just want him to testify. I wasn't going to introduce those into evidence.

The Court: If they are mere tabulations to save time, why not let them be marked as Exhibit C-1?

Let me make this suggestion, that it be marked as Exhibit C-1 and that counsel for the plaintiff, Mr. Lewis, will have an opportunity to examine it and if you have any objection to it—this matter is going to be taken under submission anyway—that you submit in the next four or five days your objections.

Mr. Lewis: That is fine if they will give me a copy of it. There were no copies made.

The Court: Let it be marked and you can get it photostated. Mr. Wyshak will provide you with a photostatic copy which you can get from the clerk's office, so that you can examine it because the method and manner of calculation and the figures may or may not be important.

(Testimony of Edwin L. Reed.)

(The document referred to was marked Defendant's Exhibit C-1 for Identification.)

The Court: Now you say you have also added up the total of Schedule E and F?

The Witness: Yes, Your Honor.

The Court: Do they have a sheet of that too?

Mr. Wyshak: No, all he has is merely the total with [58] the number of shares listed thereon. It is just a matter of arithmetic.

The Court: I do not think it is necessary for him to testify to that. You are going to file a brief, are you not?

Mr. Lewis: Yes, Your Honor.

The Court: Then you can use his figures in that brief.

Mr. Lewis: As long as they are going to put in that one page, that is perfectly all right.

The Court: Anything more from this witness?

Mr. Lewis: It will be stipulated that these summaries are correct, subject to my checking them.

The Court: That is right, and if you have any objection to it you can file it in writing in five days. And if you feel it is necessary to clarify it, I will reopen the matter and you may call another witness.

Mr. Wyshak: The foundation is waived, that he is a revenue agent?

Mr. Lewis: Yes.

Mr. Wyshak: And you are willing to stipulate that those are all the brokerage statements for the Randall Foundation for those two fiscal years? That

(Testimony of Edwin L. Reed.)

is as far as we went in the tabulation, and we didn't go beyond that time.

The Court: I take it that counsel will make that stipulation subject to his verification.

Mr. Lewis: That is correct. [59]

The Court: I would not think he would be prepared at this moment seeing a sheaf of papers to say that is it.

Is that all?

Mr. Wyshak: That is all.

The Court: Step down.

(Witness excused.)

Mr. Wyshak: May we withdraw those exhibits to have them copied?

The Court: Exhibit C?

Mr. Wyshak: Exhibit C-1.

The Court: Yes.

Is that all your witnesses?

Mr. Wyshak: That is all, Your Honor.

The Court: Any rebuttal witnesses?

Mr. Lewis: No, Your Honor.

The Court: I take it you both want to brief this question?

Mr. Lewis: Yes, Your Honor.

Mr. Wyshak: We would like to, Your Honor.

The Court: The plaintiff here will have five days to file any supplement or explanation or whatever it is to Exhibit C and Exhibit C-1 and to reopen if necessary.

How long do you want to file a brief?

Mr. Lewis: Fifteen days.

The Court: And to reply? [60]

Mr. Wyshak: I don't want to ask for more than my brother here, but may I have 20?

The Court: 20, 20 and 10, at which time the matter will be submitted.

The Clerk: Neither of these exhibits have been admitted besides Exhibit A.

The Court: Exhibit C will be admitted in evidence. Is there any objection to it?

Mr. Wyshak: I think it will only clutter up the record since we have C-1 in evidence.

The Court: Exhibit C-1 will be received in evidence and Exhibit C will remain marked for identification.

Mr. Lewis: Yes.

(The document referred to, marked Defendant's Exhibit C-1 for Identification, was received in evidence.)

DEFENDANT'S EXHIBIT C-1

FY 4/30/51

Randall Foundation, Inc.
Schedules of Securities Purchased

Month 1950	Number of Shares Aiken-Lambert	Harbison & Henderson	Total
May			
June	2,150		2,150
July	1,800		1,800
August	5,300		5,300
September	1,500		1,500
October	1,950		1,950
November	1,000	200	1,200
December	5,225	400	5,625

1951			
January	1,450	750	2,200
February	1,160		1,160
March	1,850	300	2,150
April	1,348	525	1,873
	24,733	2,175	26,908

Total shares sold per 1,120 (return) 23,185
Total shares purchased per above 26,908

Total 50,093

FY 4/30/52

Randall Foundation, Inc.
Schedules of Security Purchases

Month	Number of Shares Aiken-Lambert	Harbison & Henderson	Total
1951			
May	1,086	1,350	2,436
June	2,400	3,550	5,950
July	200¾	350	550
August	400	350	750
September	100	200	300
October	500	300	800
November	900	350	1,250
December	2,400	150	2,550
1952			
January	100	1,050	1,150
February	200		200
March			
April			
	8,286	7,650	15,936

Total sales per return 25,996
Total purchases per above 15,936

Total 41,932

[Admitted in evidence Oct. 11, 1954.]

The Court: Very well. Court is adjourned.

(Whereupon, at 3:30 o'clock p.m., Court was adjourned.) [61]

CERTIFICATE

I hereby certify that I am a duly appointed, qualified and acting official Court reporter of the United States District Court for the Southern District of California.

I further certify that the foregoing is a true and correct transcript of the proceedings had in the above-entitled cause on the date or dates specified therein, and that said transcript is a true and correct transcription of my stenographic notes.

Dated at Los Angeles, California, this 21st day of October, A.D. 1954.

/s/ AGNAR WAHLBERG,
Official Reporter.

[Endorsed]: Filed March 19, 1956. [62]

[Title of District Court and Cause.]

CERTIFICATE BY CLERK

I, John A. Childress, Clerk of the United States District Court for the Southern District of California, do hereby certify that the foregoing pages numbered 1 to 124, inclusive, contain the original

Complaint;

Answer;

Stipulation of Facts;

Findings of Fact and Conclusions of Law and Judgment;

Notice of Appeal;

Stipulation Extending Time for Filing of Bond for Costs on Appeal;

Corrected Findings of Fact, Conclusions of Law and Judgment Nunc Pro Tunc;

Designation of Contents of Record on Appeal;

Defendant's Additional Designation of Contents of Record on Appeal;

which, together with a full, true and correct copy of the Minutes of the Court had on April 6, 1955; 1 volume of reporter's transcript of proceedings of October 11, 1954; and defendant's exhibits A and C-1, all in the above-entitled cause, constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled case.

I further certify that my fees for preparing the foregoing record amount to $2.00, which sum has been paid by appellant.

Witness my hand and the seal of the said District Court this 22nd day of March, 1956.

[Seal] JOHN A. CHILDRESS,
Clerk,

By /s/ CHARLES E. JONES,
Deputy.

[Endorsed]: No. 15076. United States Court of Appeals for the Ninth Circuit. Randall Foundation, Inc., Appellant, vs. Robert A. Riddell, Director of Internal Revenue, District of Los Angeles, Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed March 23, 1956.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals for the Ninth Circuit

No. 15076

RANDALL FOUNDATION, INC.,

Plaintiff-Appellant,

vs.

ROBERT A. RIDDELL, Director of Internal Revenue, District of Los Angeles,

Defendant-Appellee.

APPELLANT'S STATEMENT OF POINTS UPON WHICH IT INTENDS TO RELY

Point I.

For both of the years here in question plaintiff was organized and operated exclusively for charitable purposes, and, therefore, is exempt from income tax for said years under Section 101(6) of the Internal Revenue Code of 1939.

A. For both of said years plaintiff's charter itself dedicated all assets and income of plaintiff perpetually to the charitable purposes stated in its charter.

B. Plaintiff's activity during the said years qualified it for exemption under said Section.

(1) The receipt of interest by Paul M. Randall from plaintiff does not affect its exemption.

(2) Plaintiff's activity in the market does not affect its exemption. It was not selling or dealing

with customers and therefore, did not compete with anyone.

(3) For neither of said years was plaintiff a "feeder" organization within the meaning of Section 301(b) of the Revenue Act of 1950.

C. The conclusion of the trial judge that plaintiff was not organized and operated exclusively for charitable purposes is contrary to the law as applied to the facts as established by the record in this case and found by the trial judge in his corrected Conclusions of Fact, other than those in Paragraphs XI, XII and XIII. The Conclusions of Fact in said latter three paragraphs are Conclusions of Law and are not properly included in the Findings of Fact.

Point II.

For its fiscal year ended April 20, 1951, plaintiff is specifically exempt from income tax under Section 302(a) of the Revenue Act of 1950.

Dated: 5/26/56.

Respectfully submitted,

GIBSON, DUNN &
CRUTCHER,

By BERT A. LEWIS,
Attorneys for
Plaintiff-Appellant.

[Endorsed]: Filed March 28, 1956.

No. 15076.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

RANDALL FOUNDATION, INC.,

Appellant,

vs.

ROBERT A. RIDDELL, Director of Internal Revenue, District of Los Angeles,

Appellee.

BRIEF FOR THE APPELLANT.

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RANDALL FOUNDATION, INC.,

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Appellee.

BRIEF FOR THE APPELLANT.

Jurisdiction.

This is an appeal from a judgment of the United States District Court of the Southern District of California, Central Division, dismissing with prejudice petitioner's (Appellant herein) complaint against Robert A. Riddell, Director of Internal Revenue, District of Los Angeles, to recover overpayment of Federal income tax for its fiscal years ended April 30, 1951 and April 30, 1952.

Appellant is a duly incorporated, non-profit California corporation, whose principal place of business is at Los Angeles, California. Its application for exemption from Federal income tax under Section 101(6) of the 1939 Internal Revenue Code was duly filed but was rejected by the Commissioner of Internal Revenue. Appellant thereafter filed income tax returns for its fiscal years ended April 30, 1951 and April 30, 1952, paid the taxes shown thereby in the amount of $6,677.13 and $14,113.24, respectively, and filed claim for refund in accordance with

the provisions of Section 3772 of the 1939 Internal Revenue Code. Defendant (Appellee herein) failed to act on said claim or to refund or credit any portion of the taxes paid. Appellant brought this action in the United States District Court for the Southern District of California, for recovery of the taxes paid in accordance with the provisions of the Internal Revenue Code and the jurisdiction conferred on said court by Title 28, U. S. C., Section 1340 and Section 1346.

This court has jurisdiction on this appeal under Title 28, U. S. C., Section 1291 and Section 1294.

Statement of the Facts.

The facts in this case are not in dispute. The principal facts are stipulated [R. 44 through 104], and the evidence submitted at the trial consisted of uncontroverted testimony explaining and clarifying these stipulated facts [R. 125, *et seq.*]. These facts, insofar as they are relevant to this appeal, are as follows:

Appellant was incorporated on or about May 11, 1950, and has ever since existed, as a non-profit California corporation under those portions of the California Corporations Code known as the General Non-Profit Corporation Law [R. 45, 54, 116].

Its entire assets are irrevocably dedicated to charitable purposes and under no circumstances can they inure to the benefit of its founder or other private person. Its Articles specifically provided:

> "That the specific and primary purpose for which said corporation is formed is to aid, assist, contribute to and/or establish charitable, religious and educational institutions, organizations and foundations.
>
> * * * * * * * *

"That the Trustees hereunder shall have equal voting power but no individual property rights in or to any assets of the foundation or corporation.

* * * * * * * *

"No member shall have any proprietary interest whatever in or to any of the assets of the corporation, and no income, increments, or other pecuniary gain, benefit, or advantage of any kind, in any way arising from or growing out of the assets of the corporation or their operation will inure to or in any way go to or vest in any member of the corporation. Upon the dissolution or winding up of the corporation, after paying or adequately providing for the debts and obligations of the corporation, and remaining assets shall be distributed to a religious, educational or charitable organization located in California and selected by the Board of Trustees."

Appellant was organized for the primary purpose of establishing a home for underprivileged boys without regard to race, creed or color [R. 21, 131, 161, 164]. Appellant's original articles stated only general charitable purposes, rather than the specific primary purpose for which it was organized. This was done on the basis of legal advice that it was unnecessary to state Appellant's specific charitable purposes [R. 164]. Subsequently the articles were amended to provide that Appellant's primary purpose is to establish a home for underprivileged boys, without regard to race, creed or color [R. 21]. At approximately the same time, the By-Laws were amended to provide that Appellant must either commence construction of a boys' home by December 31, 1957 or establish facilities for the actual residence of at least fifty boys by not later than December 31, 1959. Under California law such a provision must be in the By-Laws rather than the Articles [R. 21, 62, 164, 166].

It was estimated that an initial capital of $250,000 would be required to set up this home and that, with the combined contributions of Mr. Randall, other members of the Board, and outside persons, together with accumulated profits from Appellant's investments, it would take from two to four years to accumulate this fund [R. 150, 168]. During the three or four years preceding organization of the Randall Foundation, Mr. Randall contributed approximately 10% of his annual income to charitable organizations [R. 131]. He intended to contribute at least 10% of his income to Appellant each year after its organization and contributed securities of a fair market value of $20,752.11 during its first fiscal year [R. 131, 48, 116]. The Internal Revenue Service denied Appellant's application for exemption September 12, 1951. As a result of this denial, contributions thereafter were nominal [R. 48, 157]. During the first fiscal year Mr. Randall loaned Appellant $155,200 at an interest rate of 2½% per annum [R. 48, 49, 116], which with its other assets, it used in the purchase of securities.

Upon the organization of the foundation, Mr. Randall became its president and was delegated broad authority over the investment of its assets [R. 67, 71, 76]. He thereafter devoted a portion of his abilities to the skilled management of Appellant's investment portfolio. When he saw an opportunity to buy at a favorable price he would cause the foundation to do so. Similarly, he would cause it to sell whenever he saw that the funds could be more profitably invested elsewhere [R. 8, 51]. Such purchases and sales were made frequently.

Neither Mr. Randall nor Appellant is, nor at any time has been, a broker or dealer in securities. All purchases and sales were made through brokers who purchased or sold for Appellant either on a listed exchange or on the

over-the-counter market. Neither Appellant nor Mr. Randall knew the party from whom or to whom purchases and sales were made. No compensation was paid to Mr. Randall for his services and the only profits to any other person through these transactions were the normal brokerage fees paid to the brokers handling the sales and purchases [R. 117, 132]. Neither Mr. Randall nor any other person made any profit, directly or indirectly, from Appellant's activity.

The income, expenses, and gains from disposition and sale of securities of plaintiff for its three fiscal years ended April 30, 1951; April 30, 1952, and April 30, 1953, were as follows:

	Year Ended		
	4/30/51	4/30/52	4/30/53
Dividends and interest	$10,285.00	$ 7,081.93	$2,937.67
Expenses	1,532.36	8,271.99	5,966.03
Gains from disposition and sale of securities	30,238.27	51,079.61	5,456.01

Thus, during its first fiscal year ended April 30, 1951, Appellant accumulated, through gifts, dividends and interest, and gains on securities, approximately one-quarter of the capital which it was estimated would be required to establish the boys' home. This progress accorded with the original estimate of two to four years beore construction of the home for under-privileged boys could be begun [R. 150, 168].

During this period Mr. Randall examined properties in several areas of the state which might be purchased for the construction of the home [R. 138]. Inspection of properties continued during the second fiscal year despite the notification *on September 12, 1951* that Appellant's application for tax exemption had been denied [R. 138, 139]. Following April 30, 1952 Appellant employed Mr.

Ramsdell, a former employee of the Los Angeles City School System, to assist in investigating prospective properties on behalf of the foundation. During this period Mr. Ramsdell and Mr. Randall also made a trip to Omaha, Nebraska, to visit and study in detail the operation of Father Flanagan's Boys Home [R. 139, 140].

In addition to these activities, Appellant made gifts to other recognized charitable organizations as follows:

Date	Organization	Amount
4/24/51	Children's Hospital Society of L. A.	$ 500.00
5/26/51	Sister Elizabeth Kenny Foundation	100.00
7/22/51	St. John's Hospital	1,000.00
8/31/51	Montecito School for Girls	2,000.00
4/30/52	David Seabury School of Psychology	2,000.00
4/30/52	Bureau of Welfare, California Teachers' Association	1,000.00
4/30/52	American Red Cross	1,000.00
4/30/52	Y.M.C.A. of South Pasadena	1,000.00
4/30/52	All Nations Foundation	1,000.00
4/30/52	Children's Hospital of Los Angeles	500.00
4/30/52	Montecito Schools, Inc.	500.00
4/30/52	Girl Scouts of South Pasadena	100.00
4/30/52	Cate School	1,000.00
	Total	$11,700.00

(It will be noted that in accordance with its primary purpose of establishing a home for under-privileged boys, Appellant made only relatively small contributions to other charitable organizations until after its own application for exemption was denied.)

Appellant filed its application for exemption from Federal income tax under Section 101(6) of the Internal Revenue Code shortly after the close of its first fiscal year on April 30, 1951. Formal notice that exemption was rejected was received September 12, 1951 [R. 45, 118].

Appellant thereafter continued its efforts to secure exemption since it realized that failure to do so would delay establishment of the boys' home by preventing donations and increasing expenses by reason of the taxes payable on its other income. These efforts were unsuccessful and on June 10, 1953 income tax returns for the fiscal years ended April 30, 1951 and April 30, 1952 were filed and taxes in the amount of $6,677.13 and $14,113.24, respectively, were paid. Claims for refund were filed for both years on June 12, 1953 [R. 46]. True and correct copies of these claims and a memorandum submitted in support thereof are set forth in the record at pages 24 through 34. Said claims were not acted upon by the Bureau and this action was instituted for refund of the taxes paid. The trial court refused the refund and this appeal followed.

Issue Involved.

The issue involved in this appeal is whether Appellant was exempt from Federal income taxation for the fiscal years ended April 30, 1951 and April 30, 1952 under Section 101(6) of the Internal Revenue Code of 1939, which reads as follows:

> "Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation. For loss of exemption under certain circumstances see sections 3813 and 3814." (Underlined portion was added by the Revenue Act of 1950 and is applicable only to the fiscal year ended April 30, 1952.)

The meaning of the quoted section is affected by other explicit statutory provisions, such as Sections 302(a) and 301(b) of the Revenue Act of 1950. Said sections are quoted and discussed hereafter.

Specification of Errors.

The Appellant assigns as error the following:

Findings of Fact:

1. That plaintiff was not organized or operated exclusively for a charitable purpose during the fiscal years ended April 30, 1951 and April 30, 1952 within the meaning of Section 101(6) of the 1939 Internal Revenue Code [XI].

2. That plaintiff was operated during the fiscal years April 30, 1951 and April 30, 1952 for the primary purpose of carrying on a trade or busines for profit [XII].

3. That trading in securities and receiving dividends were plaintiff's only activities during its first year of existence [V].

4. That no charitable activity was directly carried on by the plaintiff during its second fiscal year [VI].

Conclusions of Law:

5. That plaintiff was not organized and operated exclusively for a charitable purpose during the fiscal years ending April 30, 1951 and April 30, 1952 within the meaning of Section 101(6) of the 1939 Internal Revenue Code [II].

6. That plaintiff is not entitled to exemption from Federal income taxation with respect to the fiscal years ended April 30, 1951 and April 30, 1952 under Section 101(6) of the 1939 Internal Revenue Code [III].

7. That plaintiff is not exempt from Federal income taxation for the fiscal year ended April 30, 1951 under the provisions of Section 302(a) of the Revenue Act of 1950 [IV].

8. That plaintiff is within Section 301(b) of the Revenue Act of 1950 and hence not exempt from Federal income taxation for the fiscal year ended April 30, 1952 [V].

9. The rulings of the Comissioner of Internal Revenue that plaintiff was not entitled to exemption from taxation for the fiscal years ended April 30, 1951 and April 30, 1952 were not erroneous [VI].

10. That plaintiff was operated during the fiscal years ending April 30, 1951 and April 30, 1952 for the primary purpose of carrying on a trade or business for profit [VII].

11. The defendant is entitled to judgment against the plaintiff dismissing the complaint herein with prejudice, and for his costs [IX].

The findings of fact set forth in 3 and 4, *supra,* are plainly incorrect in that they overlook the uncontroverted testimony that Appellant inspected properties throughout the state in an attempt to find and purchase land suitable for the boys' home which Appellant planned to build and operate [R. 138]. This is certainly both an "activity" and a "charitable activity." With this exception the issues on this appeal involve only the application of rules of law to undisputed facts. Appellant therefore objects not only to the correctness of the conclusions of law reached, but to specifications 1 and 2, *supra,* being denominated as findings of fact.

Summary of Argument.

1. Appellant was organized for charitable purposes.

2. Appellant was operated for charitable purposes in two different ways, each of which is sufficient for purposes of the claimed exemption:

(a) Appellant examined proposed sites for its boys' home and was engaged in accumulating the funds necessary for the establishment of such home.

(b) Appellant made substantial gifts of its assets to recognized charitable organizations.

3. The aforesaid charitable purpose of Appellant's organization and operation constituted the exclusive purpose thereof notwithstanding its activity in purchasing and selling securities. Such activity did not prevent Appellant's qualifying for exemption for the following reasons:

(a) For Appellant's fiscal year ended April 30, 1951, the statute, Section 302(a) of the Revenue Act of 1950, specifically provides that exemption cannot be denied because of such activity.

(b) For the year ending April 30, 1951, Appellant's stock market activity, even ignoring for the moment the specific exemption of Section 302(a) of the Revenue Act of 1950, was not of such a nature as to warrant denial of exemption, for the following reasons, which reasons also distinguish the instant case from the recent decisions of this Circuit in *Ralph H. Eaton v. Commissioner* (9th Cir., 1955), 219 F. 2d 527, and *John Danz Charitable Trust v. Commissioner* (9th Cir., 1955), ... F. 2d ....., 55-2 U. S. T. C. par. 9723.

(i) Such stock market activity was merely ancillary to Appellant's charitable purpose and

could not by its very nature constitute an independent purpose for Appellant's existence or operations.

(ii) The purpose of Appellant's stock market activity was not to raise funds to feed other charities but was intended as the means to assist in raising the necessary funds for Appellant to establish and operate its own charity—a home for under-privileged boys.

(iii) Appellant's stock market activity did not and could not constitute a *competitive* business such as was involved in the *Eaton, Danz* and *Community Service* cases referred to herein. Thus, the reasons of policy which dictate that competitive businesses should not be operated tax-free to the prejudice of their taxable competitors, which were involved in the cases just cited, do not apply to the instant case.

(c) For the year ending April 30, 1952, Appellant's stock market activity was not of such a nature as to warrant denial of exemption for the following reasons:

(i) The reasons summarized under (b) above with respect to the year ended April 30, 1951, are equally applicable to the year ended April 30, 1952.

(ii) The Revenue Act of 1950 extensively revised the statutory provision covering the taxability of charitable organizations. These revisions are applicable to Appellant's year ending April 30, 1952, and provide additional confirmation that Appellant is exempt under Section 101(6) of the Internal Revenue Code of 1939 for said year.

ARGUMENT.

I.

Appellant Was Organized for Charitable Purposes.

Appellant was organized as a non-profit corporation under those portions of the California Corporation Code known as the General Non-Profit Corporation Law [R. 45, 54, 116]. Its original Articles clearly stated that it was organized for charitable purposes [R. 16]. The amended Articles specify that the primary purpose is to establish a home for under-privileged boys, without regard to race, creed or color [R. 21]. Its assets are irrevocably dedicated to these purposes and cannot, under any circumstances, accrue to the benefit of its founder or other private person [R. 18]. This is so as a matter of law. The California Supreme Court has held that Articles which are far less clear than Appellant's dedicated the entire property forever to the charitable purposes stated therein:

> *In re L. A. County Pioneer Society* (1950), 40 Cal. 2d 852, 257 P. 2d 1.

Furthermore, the undisputed testimony of three witnesses is that Appellant was organized for the primary purpose of building and operating a home for under-privileged boys [R. 131, 161, 164].

There can be no question on the basis of these uncontroverted facts that Appellant was organized for charitable purposes within the meaning of Section 101(6).

> *Sico Co. v. United States* (Ct. Cl. 1952), 102 Fed. Supp. 197;
>
> *Sand Springs Home* (1927), 6 B. T. A. 198;
>
> *Jack Little Foundation For Aid to the Deaf v. Jones* (W. D. Okla. 1951), 102 Fed. Supp. 326.

II.

Appellant Was Operated for Charitable Purposes.

Appellant's activities confirmed that it was operated for the purposes for which organized. Its primary purpose was to build and operate a home for under-privileged boys. All reasonable steps were taken toward this end:

(1) Properties throughout the State were inspected during both fiscal years in question in an attempt to find a suitable location for the boys' home at a suitable price. These activities continued subsequent to April 30, 1952, and, in addition, Mr. Randall and Mr. Ramsdell visited and made a detailed inspection of Father Flanagan's Boys Home [R. 138-140].

(2) Appellant diligently attempted to supplement its income from contributions and thus hasten the day when the boys' home could be built by investing its funds in securities selected by Mr. Randall and actively selling and reinvesting whenever this profitably could be done.

Raising monies to be used for charitable purposes is just as necessary and just as much a charitable activity as spending them. Necessarily, when a charitable organization is working toward a future objective, such as building a boys' home, its charitable activities will be predominantly in raising money rather than in spending it until the required initial capital can be accumulated.

Appellant's principal purpose of building and operating a home for under-privileged boys was, by its very nature,

a project which would require a large initial investment. It would indeed be a sad commentary on the law if such projects were limited to foundations created by the very wealthy who could immediately endow them with sufficicient funds to make such a large initial expenditure.

Only a very few cases have considered the propriety of accumulating funds for future projects. Those which have, involved accumulations far less worthy and far more extreme than the one here, yet have unqualifiedly rejected any rule against accumulation.

William T. Bruckner, et al., Trustee (1930), 20 B. T. A. 419.

In this case the Will made gifts to Godair Memorial Old Peoples Homes which was incorporated as a nonprofit corporation in 1919. "The Trustees from time to time made investigations of the cost of maintenance of such a home and in regard to the various types of buildings to be erected for the purpose of the Home, and decided that a two-story building should be erected, plans for which had been drawn. The erection was, at the time of trial, expected to commence in the spring of 1930." The Trustees under the decedent's Will claimed deductions from its income for the years 1919 to 1923 for income set aside for such corporation. In holding that the trust was entitled to the deduction for the income thus permanently set aside for such corporation, the Tax Court said:

> "Its conservation during a wise consideration of how best to fulfill the charitable purpose is not at variance with the clear legislative pur-

pose of the deduction, and the statute should not be so narrowly read as to exclude situations so plainly within its beneficent intendment. * * * Clearly a corporation is operated for charitable purposes within the meaning of this statute when it actively sells some of its property in order to invest it more suitably for the charitable purpose of its creation and also employs an architect and otherwise engages in preliminary research to carry forward its main project of building and maintaining a charitable home."

William T. Buckner, et al., Trustee (1930), 20 B. T. A. 419, 423.

Ohio Furnace Company, Inc. (1955), 25 T. C. number 27, at p. 11:

"Remaining is the question whether the use by the Foundation of substantially all of its income for making the investment in Furnace Company stock, as contrasted with immediate and direct application thereof to the Shattuck School or other comparable schools, makes the operation of the Foundation other than an operation exclusively for educational purposes within the meaning of section 101(6). The only reference in the statute bearing specifically upon the use of income is the prohibition that no part of the net earnings of the corporation, fund or foundation may inure to the benefit of any private shareholder or individual. Conversely, it is reasonable to conclude, we think, that the requirements of 101(6) are satisfied if all of the income inures to the benefit of, or is in promotion of, an operation which is exclusively educational. *Certainly there is no requirement that the income must either be used or distributed in the year realized for the described purpose, and we know of no case wherein a corporation, fund, or foundation was denied exempt status*

merely because it accumulated its income for distribution in a succeeding or later year." (Emphasis added.)

Schoellkoff v. United States (2nd Cir. 1942), 124 F. 2d 982.

(A trust which was to accumulate its income for *one hundred years* for charitable purposes was held to be one organized and operated exclusively for the requisite charitable purposes.)

In *Hanover Improvement Society v. Gagne* (1st Cir., 1937), 92 F. 2d 888, a corporation organized for civic improvement purposes operated a theater building under lease as a source of income, and a portion of this income was accumulated for the purpose of purchasing a new theater building. The company was held exempt as a civic league not organized for profit "but operated exclusively for the promotion of social welfare."

Even if we assume that the accumulation must be a reasonable one, something which the existing cases do not require, there can be no question that Appellant's accumulation was reasonable. It was originally estimated that two to four years accumulation would be required. Almost 25% of the required capital was accumulated during Appellant's first fiscal year. Even with contributions cut off by the adverse ruling on Appellant's exemption an additional 20% was added in the second year [R. 52, 150, 168]. There can thus be no question that the two to four year estimate was reasonably accurate, and that the accumulation called for was reasonable.

Appellant submits that, when a concrete and realistically obtainable objective is chosen and all reasonable steps are taken towards its consummation, exemption cannot be denied because the nature of the project prevents large-scale charitable activities during the fund raising period.

In addition to the above activities, which in themselves are clearly sufficient to meet the statutory requirement, it will be noted that during the years here in question taxpayer also contributed to acknowledged and qualified charitable institutions gifts totaling $11,700.00. Such contributions in themselves constitute a sufficient charitable activity to qualify the donor for exemption. This has been an accepted principle for so long that no case has been found in which it has even been questioned. The answer undoubtedly lies in the fact that in 1924 the Bureau of Internal Revenue itself ruled that:

> "A corporation formed to dispense charity which does not actually engage in charitable undertakings itself but distributes its income to institutions organized and operated exclusively for the purposes of subdivision (6) of Section 231 is exempt from taxation under said section."
>
> I. T. 1945, III-1, C. B. 273 (1924).

From the above it is clear that Appellant was at all times operated for charitable purposes in conformity with its charter which as a matter of law required such an operation. Thus, the only question remaining is whether or not the frequency of Appellant's purchases and sales in the stock market could operate to deny Appellant the exemption to which it is otherwise clearly entitled.

III.

Appellant's Otherwise Exempt Status Is in No Way Affected by the Frequency of Its Purchases and Sales of Securities.

Fiscal Year Ended April 30, 1951

A. Even Assuming for the Moment, Contrary to the Arguments Set Forth in Sub-section (b) Hereafter, That Appellant's Purchases and Sales of Securities Constituted the Carrying on of a Trade or Business for Profit, Section 302(a) of the Revenue Act of 1950 Specifically Prohibits the Denial of Exemption Because of Such Activity.

Section 302(a) of the Revenue Act of 1950 provides:

> "Sec. 302. Exemption of Certain Organizations For Past Years.
>
> (a) Trade or Business Not Unrelated.—For any taxable year beginning prior to January 1, 1951, no organization shall be denied exemption under paragraph (1), (6), or (7) of section 101 of the Internal Revenue Code on the grounds that it is carrying on a trade or business for profit if the income from such trade or business would not be taxable as unrelated business income under the provisions of Supplement U of the Internal Revenue Code, as amended by this Act, or if such trade or business is the rental by such organization of its real property (including personal property leased with the real property)."

In short, for a taxable year beginning prior to January 1, 1951, an organization cannot be denied exemption on the ground that it was carrying on a trade or business for a profit unless it had unrelated business income taxable under Supplement U.

There is no suggestion that Appellant had any unrelated business income as defined in Supplement U for its

fiscal year ended April 30, 1951. Nor could such a suggestion be made since all of Appellant's income fell into one of the categories specifically exempted from the definition of unrelated business income by Section 422(a)(1) and (5) of the I. R. C. of 1939:

> "There shall be excluded all dividends, interest, and annuities, and all deductions directly connected with such income.
>
> "There shall be excluded all gains or losses from the sale, exchange, or other disposition of property other than (A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or (B) property held primarily for sale to customers in the ordinary course of the trade or business."

Moreover, under Section 422(b)(1), Appellant cannot even be considered as being in an unrelated trade or business since (even assuming, contrary to the above, that it did have unrelated business income) the statute excludes from its definition of an unrelated trade or business any trade or business:

> "in which substantially all the work in carrying on such trade or business is performed for the organization without compensation."

The only possible remaining question is whether Appellant was denied exemption on the ground that it was carrying on a trade or business for profit.

As will be discussed at length hereinafter, Appellant submits that it was not carrying on a trade or business for profit. But, there can be no question that this was the ground on which its exemption was denied by the Court below.

Finding of Fact XII [R. 121] and Conclusion of Law VII [R. 122] state that plaintiff was operated for the primary purpose of carrying on a trade or business for profit. Finding of Fact XI [R. 121] and Conclusion of Law II [R. 121] state that plaintiff was not organized and operated *exclusively* for charitable purposes. It is undisputed that Appellant was organized for charitable purposes [R. 21, 131, 161, 164] and that it engaged in charitable activities [R. 51, 117, 119, 138 through 140]. There can, therefore, be no question that Appellant was denied exemption on the ground that it was operated primarily to conduct a trade or business for profit, and hence was not organized and operated exclusively for charitable purposes. *This is precisely the ground on which Section 302(a) forbids exemption being denied.*

Appellant respectfully submits that the determination of the Court below that Section 302(a) does not prevent denial of Appellant's exemption for the fiscal year ended April 30, 1951, is unquestionably erroneous.

B. Even Ignoring for the Moment the Specific Exemption of Section 302(a) Discussed Above, Appellant's Stock Market Activity Was Not of Such a Nature as to Warrant Denial of Exemption.

No informed person would ever suggest that an exempt organization must limit its fund raising activities to the solicitation of contributions. It is now much too common to see schools, churches and other accepted charities raising funds through paper drives, dinners, bazaars and assorted other activities which are in no way related to their charitable purposes except to provide funds. Perhaps such activities should be taxed, as many now are under Supplement U, but they should not be the basis of denying general exemption to the organization.

Investment in stocks and bonds for both current income and appreciation is a particularly well accepted source of income for many exempt organizations. It is well known that many colleges today derive most of their income from their investments and utilize the talents of businessmen and stock market analysts to manage actively their investment portfolios. Some have only a relatively light turn-over in investments, but many, like Appellant, have the benefit of top grade investment advice and actively buy and sell.

We submit that on principle there is no reason for basing tax exemption on the number of purchases and sales taking place within a particular year. Such activity may be expanded or contracted as the needs of the charitable purposes demand. Thus, it is always ancillary to such purposes.

It is well known that certain types of businesses tend to become ends or purposes in themselves. An automobile agency or spaghetti factory requires the hiring of employees, building of a business organization, buying equipment, obtaining customers and a variety of other activities. The business cannot expand and contract depending on whether its founders are accumulating funds for a future project or currently spending them. It is by its nature permanent in form and endowed with needs and demands of its own. The needs of a charitable beneficiary will generally be subordinate to the demands of the business. This is not so with the purchase of securities. By its nature, it is an investment activity where excess funds can be invested or withdrawn so as to conform to the ultimate charitable purpose.

The fundamental nature of such activity is not changed by the volume of purchases and sales made. This is

recognized in the cases establishing that, regardless of volume of sales, all gains from sales of securities for one's own account are taxable as capital gains.

Pacific Affiliates, Inc., 18 T. C. 1175 at 1212 (1952), Acq. C. B. 1953-19, 1.

George R. Kemon (1951), 16 T. C. 1026.

This is true because such gains result from a change in value of the securities rather than a mark-up for services performed. The Tax Court has clearly explained this difference in the nature of a dealer's and trader's profit as follows:

> "Those who sell 'to customers' are comparable to a merchant in that they purchase their stock in trade, in this case securities, with the expectation of reselling at a profit, not because of a rise in value during the interval of time between purchase and resale, but merely because they have or hope to find a market of buyers who will purchase from them at a price in excess of their cost. This excess or mark-up represents remuneration for their labors as a middle man bringing together buyer and seller, and performing the usual services of retailer or wholesaler of goods. *Cf. Schafer v. Helvering, supra; Securities-Allied Corp. v. Commissioner,* 95 F. 2d 384, certiorari denied, 305 U. S. 617, affirming 36 B. T. A. 168, *Commissioner v. Charavay,* 79 F. 2d 406, affirming 29 B. T. A. 1255. Such sellers are known as 'dealers.'
>
> "Contrasted to 'dealers' are those sellers of securities who perform no such merchandising functions and whose status as to the source of supply is not significantly different from that of those to whom they sell. That is, the securities are as easily accessible to one as the other and the seller performs no services that need be compensated for by a mark-up

> of the price of the securities he sells. The sellers depend upon such circumstances as a rise in value or an advantageous purchase to enable them to sell at a price in excess of cost. Such sellers are known as 'traders.' "

This view is confirmed by the Supreme Court's decision in *Higgins v. Commissioner* (1940), 312 U. S. 211, 61 Sup. Ct. 475, holding that an individual investor was not engaged in a trade or business for income tax purposes even though he had engaged in numerous transactions throughout the taxable period.

It should be noted in both the *Eaton* (9th Cir. 1955) 219 F. 2d 527, and *Danz* (9th Cir. 1955) 55-2 U. S. T. C. Par. 9723, cases that the organizations involved were engaged in businesses which as explained above would develop ends and purposes in themselves and thus could not be ancillary to the ultimate charitable purpose of the organization. A second difference between the instant case and the facts involved in the *Eaton* and *Danz* cases lies in the permanent feeder nature of the organizations there involved. The circumstances before the Court in each such case have been the same: a feeder organization, organized and operated to run commercial enterprises having their own independent needs and demands and never intended itself to engage in charitable activities. Its only claim to exemption was that its profits must eventually be given to charitable organizations.

These cases emphasize that the organization had no intention of engaging itself in charitable activities:

> "Clearly, however, the corporation itself was not intended to operate and did not operate as a religious, educational or charitable institution. What was proposed was only that the profits from its various busi-

ness activities would be turned over to such institutions."

Ralph H. Eaton Foundation v. Commissioner of Internal Revenue (9th Cir., 1955), 219 F. 2d 527.

In sharp contrast with this situation is the fact that Appellant is itself a charitable organization and not merely a feeder. Its amended Articles [R. 21] and By-Laws [R. 62] supported by the uncontroverted testimony of Mr. Randall [R. 121], Dr. Bailes (a minister of religion and one of the original Trustees) [R. 161], and Mr. Flanagan (one of the original Trustees and the attorney who drew the Articles) [R. 164], show beyond any doubt that Appellant was organized for the specific and primary purpose of building and operating *itself* a home for under-privileged boys.

Appellant could, under its Articles, also make gifts to other charitable organizations. It did so, particularly after its own exemption was denied. Such gifts undoubtedly provide additional confirmation that Appellant was organized and operated for charitable and not business purposes. But, they were temporary in nature and are not the primary basis for its exemption. They are completely incidental to its stated primary purpose of building and operating itself a home for under-privileged boys. Gifts to other charities by an organization which is itself organized and operated for charitable purposes does not convert it into a feeder organization in any sense of the term.

A third important difference between the instant case and the facts involved in the *Eaton* and *Danz* cases is that the organizations there involved were operating commercial enterprises in competition with tax-paying busi-

nesses. In the *Eaton* case, this Court relied upon and referred to the Fourth Circuit's decision in the *Community Services* case, *United States v. Community Services* (4th Cir., 1951), 189 F. 2d 421. In that case, the Fourth Circuit stressed such competitive nature of the business involved at page 425 stating:

> "Manifestly, a corporation engaged in commercial activities, if exempt from federal taxes, would have a tremendous economic advantage over competitors in the same field. Such a corporation could effectively eliminate competitors, actual and potential, since it could undersell corporations, whose earnings are subject to diminution by federal taxation. It is difficult to believe that Congress intended to countenance such a situation."

Appellee must concede that Appellant was not a dealer in securities. It did not maintain a business organization, nor an inventory of securities for sale to customers. All it did was buy and sell securities for its own account from or to unknown principals, and collect the dividends thereon.

Its activity is passive in nature, and it competes for no one's customers. As stated by the Senate Finance Committee in its Report No. 2375, 81st Congress, 2nd Session, 1950 C. B. page 483 at 505, in explaining why the 1950 Revenue Act excluded capital gains from unrelated business income:

> "Your Committee believes that they are 'passive' in character and are not likely to result in serious competition for taxable businesses having similar income. Moreover, investment producing incomes of these types have long been recognized as a proper source of revenue for educational and charitable organizations and trusts."

To summarize, it is respectfully submitted that neither the holding nor dicta of the *Eaton* and *Danz* cases is applicable to the instant case for the three reasons above explained:

(1) Appellant's market activity was passive and ancillary to its ultimate charitable purpose, whereas the activity involved in the cases referred to was of such a nature that it developed its own ends and purposes and could not be merely ancillary to a charitable purpose.

(2) Appellant is a charitable organization organized and operated to accomplish its own charitable purpose, whereas the organizations involved in the cases referred to never intended to engage in charitable activity but were merely intended to feed their income or profits to other charities.

(3) Appellant in its stock market activity did not compete with anyone, whereas the organizations involved in the cases referred to engaged in commercial enterprises which competed for the customers of tax-paying businesses.

Because of these three differences, it is respectfully submitted that Appellant's otherwise exempt status should not be denied because of its activities in which it bought and sold securities. Thus, Appellant is clearly entitled to exemption for its year ended April 30, 1951, wholly aside from the clear and independent exemption afforded it by Section 302(a) of the Revenue Act of 1950.

Fiscal Year Ended April 30, 1952

C(1) For Its Fiscal Year Ended April 30, 1952, Appellant's Otherwise Exempt Status Is Not Affected by the Frequency of Its Purchases and Sales of Securities for the Reasons Summarized Under Section III-B Above, Which Are Equally Applicable to the Year Ended April 30, 1952.

As previously noted, prior to the Revenue Act of 1950 the only statutory provisions applicable to Appellant's exemption was Internal Revenue Code Section 101(6). This section was retained unchanged by the Revenue Act of 1950, except for the addition of the last sentence thereto quoted below, and provides for exemption of:

> "Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation. For loss of exemption under certain circumstances see sections 3813 and 3814."

The discussion above in subsection B setting forth the reasons why Section 101(6) could not reasonably be construed to deny exemption to Appellant for its fiscal year ended April 30, 1951, is equally applicable to its subsequent fiscal years. However, it is even more persuasive in 1952 because confirmed by the detailed provisions added by the Revenue Act of 1950.

C(2) The Revenue Act of 1950 Extensively Revised the Statutory Provision Covering the Taxability of Charitable Organizations. These Revisions Are Applicable to Appellant's Year Ending April 30, 1952, and Provide Additional Confirmation That Appellant Is Exempt Under Section 101(6) of the Internal Revenue Code of 1939 for Said Year.

The statutory provisions governing exemption were completely revised by the Revenue Act of 1950. The wording of Section 101(6) quoted in Section III C(1) above was not changed but detailed explanatory provisions were added to Section 101(6) and other portions of Section 101 to define the conditions under which exemptions would be lost in whole or part. Due to their length, Appellant has not attempted to set out the complete text of the 1950 Amendments, but has attached abstracts of relevant portions in Appendix A.

I. R. C. Section 3813 denies exemption if an organization engages in any of the list of prohibited transactions set forth therein. Appellee must concede that Appellant did not engage in any prohibited transactions.

I. R. C. Section 3814 denies exemption in certain cases of unreasonable accumulation of income. As has already been discussed in detail, Appellant planned to accumulate income for from two to four years. This is clearly not an unreasonable accumulation within the meaning of Section 3814 or any other definition of unreasonable accumulations. If there is any doubt on this point it is clearly dispelled by consideration of the legislative history of this provision of the 1950 Revenue Act. The final language making the exemption dependent upon an "unreasonable accumulation" was considered to be more liberal for the charitable organizations involved than the original provisions of the House Bill which had set specific test as to how much of an accumulation could be

permitted. However, the House Bill permitted a specific exception for an accumulation of funds for five years or less for a specific purpose, explaining the reasons for said exception in the following language:

> "Your committee believes such an exception is desirable in order to permit an organization to commit its income over several years for a specific project which cannot be financed out of one year's income or which cannot be put into operation immediately."
>
> *H. R. Report No. 2319, 81st Congress, Second Session,* 1950 C. B. 380 at 411.

Supplement U levies a tax on the unrelated business income in excess of $1,000 of certain specified exempt organizations. I. R. C. Section 422(b) specifically excludes from the definition of an unrelated trade or business any trade or business in which substantially all of the work in carrying on the business is performed without compensation. Section 422(a) excludes income from dividends, interest and capital gains from the definition of unrelated business income. Either of these subsections is in itself clearly sufficient to prevent taxation of Appellant under Supplement U.

Section 101 of the 1939 Internal Revenue Code was amended to incorporate by reference the tests of Sections 3813, 3814 and Supplement U. There was also added to it a new paragraph as follows, which prevented feeder organizations from qualifying for exemption:

> "An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under any paragraph of this section on the ground that all of its profits are payable to one or more organizations exempt under this section from taxation. For the purposes of this paragraph

> the term 'trade or business' shall not include the rental by an organization of its real property (including personal property leased with the real property)."

The court below determined as Conclusion of Law Number V [R. 122] that Appellant is within the feeder organization amendment and hence not exempt. Appellant submits that this Conclusion is clearly erroneous for the following reasons:

(1) The above provision only applies to an organization which claims exemption solely on the ground that all of its profits are payable to another exempt organization. Appellant claims exemption because of its own charitable purposes and activities and is therefore not affected by said section. Stated in another way, the use of the word "payable," rather than the word "paid" in the above provision, indicates a situation where such profits must be paid to other charitable organizations. Such is not the case with appellant since the only contributions it made to other charities were purely of its own volition. In other words, if the Appellant had been *required* to pay its profits to other charities it might fall within the above quoted language but, since this is not the case, the above language does not apply to Appellant.

(2) Wholly aside from the above reasons the above section does not apply because Appellant was not carrying on any "trade or business for profit" within the meaning of that phrase as used in said section. An examination of the 1950 Committee Reports confirms this construction. Both the House and Senate Reports use the manufacture of automobiles to illustrate the type of trade or business referred to. The cases cited in the Reports give, by implication, additional illustrations such as the

manufacture of spaghetti. These illustrations leave little doubt that the phrase "operation of a trade or business for profit" refers to the operation of a commercial enterprise furnishing products or services to customers and competing for customers. There is not the remotest suggestion that an activity such as the purchase and sale of securities for one's own account should be included.

(3) A third reason why the feeder provision is not applicable to Appellant is that the "primary purpose" of its organization was not the purchase and sale of securities but the establishment and operation of a home for under-privileged boys.

The discussion above clearly shows that Appellant was neither taxable nor declared non-exempt under any of the detailed provisions of the 1950 Revenue Act. The only remaining question is whether it could conceivably still not be exempt.

Prior to the Revenue Act of 1950, exemption had been challenged in a number of cases on the ground that the organization was operated for business purposes and hence not exclusively for charitable purposes as required by the statute.

In each case the government contended that exemption should be denied because:

> (1) The organization was deriving business income in no way related to its charitable purposes by the active conduct of a commercial enterprise; and
>
> (2) This was its only activity except to pay its profits over to recognized charitable organizations.

In almost every case the government lost—*i.e.,* the court declared that Section 101(6) allowed exemption regardless of these factors. This court can properly take

judicial notice that the 1950 Act was passed as a result of the criticism leveled against these decisions. The 1950 Amendment specifically provided that:

> (1) An organization operated primarily to carry on a business for profit which claimed exemption solely on the ground of its gifts to other exempt organizations, should no longer be exempt.
>
> (2) Even though an organization did not lose its exemption under (1) it would be taxable on any unrelated business income as defined in Supplement U.

It need scarcely be added it was assumed that if an organization was neither non-exempt under (1) nor taxable on unrelated business income under (2), it would not lose its exemption under Section 101(6) by reason of its so-called business activities.

This is made very clear by the Senate Committee Report to Section 302(a). It will be recalled that Section 302(a) provides that for years prior to the effective date of the 1950 Act, organizations shall not be denied exemption on the ground that they are carrying on a trade or business for a profit unless they had unrelated business income as defined in Supplement U. The Committee Report comments:

> "This is to assure that no more strict rule will be applied for such years than will be applied in the future under the bill."
>
> Senate Committee Report No. 2375, p. 118.

It would be difficult to imagine a clearer expression of Congressional intent that for years after the effective date

of the Act no organization could be denied exemption on the ground that it was carrying on a trade or business for profit unless it had unrelated business income as defined in Supplement U.

Conclusion.

After this case had been submitted in the lower court, this Circuit decided the case of *Ralph H. Eaton Foundation v. Commissioner* (9th Cir. 1955), 219 F. 2d 527. That decision upon its promulgation was immediately submitted to the lower court, and undoubtedly had a most important influence on its decision against Appellant. In this brief we have demonstrated the many differences existing in the *Eaton* case and the instant facts which, we submit, would require that the instant case be decided differently from the *Eaton* case even if both had involved the same statutory provisions. However, the vital difference is that the *Eaton* case, as well as the *Danz* case hereinabove referred to, involved years prior to 1950 which were not affected in any way by the elaborate changes in the statute bearing on the instant question which were made by the Revenue Act of 1950.

We have demonstrated that the change applicable to Appellant's year ended April 30, 1951, embodied in Section 302(a) of the Revenue Act of 1950, clearly and explicitly states the intention of Congress that an organization such as Appellant should be exempt. Furthermore, the quotations from the applicable Committee Reports discussed in Part III C (2) herein clearly demonstrate that Congress intended that, through the various detailed

amendments which the 1950 Revenue Act made which are applicable to Appellant's year ended April 30, 1952, the same tax rule would be produced for that and subsequent years as Section 302(a) did for Appellant's year ended April 30, 1951. It is this clear Congressional intent which governs the instant case and which requires that the judgment of the lower court be reversed.

Respectfully submitted,

GIBSON, DUNN & CRUTCHER,

Attorneys for Appellant.

APPENDIX A.

Section 101 (relevant portions, as amended by the Revenue Act of 1950 and applicable to Appellant's fiscal year ended April 30, 1952):

"Except as provided in paragraph (12)(b) and in supplement U, the following organizations shall be exempt from taxation under this chapter—

"Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholders or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation. For loss of exemption under certain circumstances see sections 3813 and 3814.

"An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under any paragraph of this section on the ground that all of its profits are payable to one or more organizations exempt under this section from taxation. For the purposes of this paragraph the term 'trade or business' shall not include the rental by an organization of its real property (including personal property leased with the real property.)

"Notwithstanding paragraph (12)(B) and supplement U, an organization described in this section (other than in the preceding paragraph) shall be

considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes."

Supplement U (Extracts of Relevant Portions):

IRC Section 421:

"(a) In General.—There shall be levied, collected, and paid for each taxable year beginning after December 31, 1950—

"(1) upon the supplement U net income (as defined in subsection (c)) of every organization described in subsection (b)(1), a normal tax of 25 per centum of the supplement U net income, and a surtax of 22 per centum of the amount of the supplement U net income in excess of $25,000; except that (A) in the case of taxable years beginning before April 1, 1951, and ending after March 31, 1951, the normal tax shall be 28¾ per centum of the Supplement U net income, and (B) in the case of taxable years beginning after March 31, 1951, and before April 1, 1954, the normal tax shall be 30 per centum of the Supplement U net income.

* * * * * * * *

"(c) Definition of Supplement U Net Income.—The term 'supplement U net income' of an organization means the amount by which its unrelated business net income (as defined in section 422) exceeds $1,000."

IRC Section 422:

"(a) Definition.—The term 'unrelated business net income' means the gross income derived by any organization from any unrelated trade or business (as defined in subsection (b)) regularly carried on by it, less the de-

ductions allowed by section 23 which are directly connected with the carrying on of such trade or business, subject to the following exceptions, additions, and limitations:

"(1) There shall be excluded all dividends, interest, and annuities, and all deductions directly connected with such income.

* * * * * * * *

(5) There shall be excluded all gains or losses from the sale, exchange, or other disposition of property other than (A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or (B) property held primarily for sale to customers in the ordinary course of the trade or business. This paragraph shall not apply with respect to the cutting of timber which is considered, upon the application of section 117(k)(1), as a sale or exchange of such timber.

* * * * * * * *

"(b) Unrelated Trade or Business.—The term 'unrelated trade or business' means in the case of any organization subject to the tax imposed by section 421(a), any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 101 (or, in the case of an organization described in section 421(b)(1)(B), to the exercise or performance of any purpose or function described in section

101(6)), except that such term shall not include any trade or business—

"(1) in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or

"(2) which is carried on, in the case of an organization described in section 101(6) or in the case of a college or university described in section 421 (b)(1)(B), by the organization primarily for the convenience of its members, students, patients, officers, or employees; or

"(3) which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions."

Section 3813:

"(b) Prohibited Transactions.—For the purposes of this section, the term 'prohibited transaction' means any transaction in which an organization subject to the provisions of this section—

"(1) lends any part of its income or corpus without the receipt of adequate security and a reasonable rate of interest, to;

"(2) pays any compensation, in excess of a reasonable allowance for salaries or other compensation for personal services actually rendered to;

"(3) makes any part of its services available on a preferential basis to;

"(4) makes any substantial purchase of securities, or any other property, for more than adequate consideration in money or money's worth, from;

"(5) sells any substantial part of its securities or other property, for less than an adequate consideration in money or money's worth, to; or

"(6) engages in any other transaction which results in a substantial diversion of its income or corpus to;

"the creator of such organization (if a trust); a person who has made a substantial contribution to such organization; a member of the family (as defined in section 24 (b)(2)(D)) of an individual who is the creator of such trust or who has made a substantial contribution to such organization; or a corporation controlled by such creator or person through the ownership, directly or indirectly, of 50 per centum or more of the total combined voting power of all classes of stock entitled to vote or 50 per centum or more of the total value of shares of all classes of stock of the corporation.

"(c) Denial of Exemption to Organizations Engaged in Prohibited Transactions.—

"(1) General Rule.—No organization subject to the provisions of this section which has engaged in a prohibited transaction after July 1, 1950 shall be exempt from taxation under section 101(6).

"(2) Taxable Years Affected.—An organization shall be denied exemption from taxation under section 101(6) by reason of paragraph (1) only for taxable years subsequent to the taxable year during which it is notified by the Secretary that it has engaged in a prohibited transaction, unless such organization entered into such prohibited transaction with the purpose of diverting corpus or income of

the organization from its exempt purposes, and such transaction involved a substantial part of the corpus or income of such organization."

Section 3814:

"In the case of any organization described in section 101(6) to which section 3813 is applicable, if the amounts accumulated out of income during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year—

"(1) are unreasonable in amount or duration in order to carry out the charitable, educational, or other purpose or function constituting the basis for such organization's exemption under section 101(6); or

"(2) are used to a substantial degree for purposes or functions other than those constituting the basis for such organization's exemption under section 101(6); or

"(3) are invested in such a manner as to jeopardize the carrying out of the charitable, educational, or other purpose or function constituting the basis for such organization's exemption under section 101(6),

"exemption under section 101(6) shall be denied for the taxable year."

No. 15076

In the United States Court of Appeals for the Ninth Circuit

RANDALL FOUNDATION, INC., APPELLANT

v.

ROBERT A. RIDDELL, DIRECTOR OF INTERNAL REVENUE, DISTRICT OF LOS ANGELES, APPELLEE

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA

BRIEF FOR THE APPELLEE

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CITATIONS

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BRIEF FOR THE APPELLEE

OPINION BELOW

The District Court wrote no opinion.

JURISDICTION

This appeal involves federal income taxes for the fiscal years ending April 30, 1951 and 1952. The taxes in dispute, in the amount of $20,790.37, were paid on June 10, 1953. (R. 5.) Claims for refund were filed on June 12, 1953. (R. 24–34.) No action was taken on the claims by the Commissioner of Internal Revenue. (R. 15.) Within the time provided in Section 3772 of the Internal Revenue Code of 1939, and on December 18, 1953, taxpayer brought an action in the District Court for recovery of the taxes paid. (R. 3-40.) Jurisdiction is conferred on the District Court

by 28 U. S. C., Section 1340. The District Court entered a minute order on April 6, 1955. (R. 104.) Judgment was entered on January 23, 1956, and a judgment *nunc pro tunc* was entered on March 1, 1956. (R. 112–113, 123.) On February 20, 1956, a notice of appeal was filed. (R. 113.) Jurisdiction is conferred on this Court by 28 U. S. C., Section 1291.

QUESTION PRESENTED

Whether taxpayer was organized and operated exclusively for charitable purposes during the fiscal years ending April 30, 1951, and April 30, 1952, within the meaning of Section 101 (6) of the Internal Revenue Code of 1939, so as to entitle it to an exemption from federal income taxes.

STATUTES AND REGULATIONS INVOLVED

The relevant provisions are included in the Appendix, *infra.*

STATEMENT

The relevant facts, which were found by the District Court (R. 115–121), may be summarized as follows:

Taxpayer was organized on May 11, 1950, as a nonprofit corporation under the laws of the State of California. Its articles provided that its purpose was the promotion and advancement of charitable, religious and educational projects on a nonprofit basis, and that no member should have any proprietary interest in its assets or income. Its original board of trustees consisted of Paul M. Randall, Frank R. Randall, his son, Dorothy R. Ward, his sister, Frederick W. Bailes and James A. Flanagan. (R. 116.)

Taxpayer's capital consisted of contributions made to it by Paul Randall (hereinafter referred to as Randall) during its first fiscal year ending April 30, 1951, of shares of stock with a market value of $20,752.11 then owned by Randall and in which he had a substantial profit. Some of these shares were sold by taxpayer the same day or the day following the contribution. No gain was reported either by taxpayer or Randall on the disposition of these shares so that the difference between the sale price and the original purchase price paid by Randall was unreported as taxable income. (R. 116.) During its second fiscal year Randall contributed to taxpayer securities with a market value of only $672.97. No gifts or contributions were at any time solicited from or made by any other person. (R. 118–119.)

Between June 13, 1950, and April 5, 1951, Randall loaned to taxpayer a total of $155,200 at an interest rate of 2½% per annum. These moneys had been borrowed by Randall from his brokers on his personal margin account with his own securities as collateral. At the time of the first loan the interest rate at which he was borrowing was only 2% per annum with subsequent increases to 3%. These loans were repaid to Randall by taxpayer as follows: $40,000 on May 29, 1951; $30,000 on December 27, 1951; and $85,200 on February 4, 1952. (R. 116–117.)

With the proceeds from the sales of these initial contributions and loans, taxpayer traded in securities, most of which were oil stocks listed on the Los Angeles Stock Exchange. The result was a net profit to tax-

payer from security transactions during its fiscal year ended April 30, 1951, of $30,238.27. In addition, taxpayer received $10,285 in dividends from these stocks. These were taxpayer's only activities during its first year of existence. In that year it purchased 26,908 shares of stock and sold 23,185 shares. Of these transactions, sales of only 150 shares resulted in long-term gain; the remaining sales constituted short-term transactions. (R. 117.) Profit from security transactions during taxpayer's second fiscal year ended April 30, 1952, totaled $51,079.61 [1] and dividends received totaled $7,081.93, for a total gross income of $58,161.54. Gains were both long and short term and resulted from the sale of 25,996 shares of stock and the purchase of 15,936 shares of stock. (R. 119.) During its first fiscal year taxpayer's expenses amounted to $1,532.36. Taxpayer's expenses during its second fiscal year, incurred in large part to obtain exemption from income tax, totaled $8,271.99. (R. 118, 119.)

All of taxpayer's sales and purchases of securities were made by Randall on taxpayer's behalf through two brokerage houses utilized by Randall for his personal accounts. The same customer's men who had serviced Randall in his individual capacity executed orders from Randall on behalf of the foundation. Randall was authorized by taxpayer's board of trustees to make trades without regard to the nature of the security and without further formal authority

[1] The District Court erroneously listed taxpayer's profit from security transactions as $50,079.61, instead of $51,079.61. However, see paragraph VII 3 of taxpayer's complaint. (R. 7.)

from the board. After Randall started trading on behalf of the foundation his market activities on his own behalf diminished considerably. In carrying on these activities for taxpayer Randall acted as a trader and not as a dealer. (R. 117, 119–120.)

One week before the close of its first fiscal year, taxpayer made a $500 contribution to the Children's Hospital Association of Los Angeles. This was a little more than 1% of taxpayer's gross income for its first year of operation. (R. 117–118.) Taxpayer contributed $11,200 to various charities during its second fiscal year. However, almost 75% of these contributions were made on the last day of its second fiscal year, despite the fact that income was being earned throughout the year. The board of trustees felt that these contributions might help secure a tax-exempt status for taxpayer. (R. 119.) No charitable activity whatsoever was engaged in by taxpayer during its first fiscal year, except for the one contribution, and no charitable activity was directly carried on by taxpayer during its second fiscal year. (R. 118, 119.)

Shortly after its first fiscal year ended, taxpayer filed a request with the Internal Revenue Service for a ruling that it was exempt from income tax under Section 101 (6) of the Internal Revenue Code of 1939. The Commissioner of Internal Revenue ruled that it was not entitled to an exemption, stating (R. 118):

> It is the opinion of this office that the income received by you has not been devoted to the purposes for which you were incorporated in such a manner and to such an extent as to con-

> stitute operations for such purposes within the meaning of section 101 (6) of the Code. Furthermore, your activities are primarily those of an organization engaged in the ordinary business of buying and selling securities. An organization which is operated for the primary purpose of carrying on a trade or business for profit is not exempt from Federal income tax notwithstanding all of its profits are payable to organizations or purposes specified in section 101 (6) of the Internal Revenue Code.

Taxpayer filed several requests for reconsideration of this ruling with the Internal Revenue Service, which culminated in a ruling dated January 8, 1953, which concluded as follows (R. 120):

> A review has been made of the evidence which formed the basis of Bureau rulings of September 12, 1951, January 15, 1952, and June 16, 1952, in connection with the information subsequently submitted and the statements made at conferences held with representatives of this office in connection with this matter. It is believed on the basis of the facts and evidence submitted, that your activities have been primarily those of an organization engaged in the ordinary business of buying and selling securities, and that there is no error in the conclusion reached in Bureau rulings of September 12, 1951, January 15, 1952, and June 16, 1952, and they are therefore hereby affirmed.

Taxpayer then filed its income tax returns for the fiscal years ended April 30, 1951, and April 30, 1952, and paid the amount of its tax liabilities for those

years shown thereon to the District Collector of Internal Revenue, following which it filed claims for refund and brought this proceeding in the District Court. (R. 120–121.)

The District Court found that taxpayer was not organized or operated exclusively for charitable purposes during the fiscal years involved herein within the meaning of Section 101 (6) of the 1939 Code, but that taxpayer was operated for the primary purpose of carrying on a trade or business for profit and that all of its income realized during these two years was derived from the operation of its business of buying and selling securities. (R. 121.) Thereupon the District Court concluded that taxpayer was not entitled to an exemption from federal income taxation for these years under either Section 101 (6) or (14) of the 1939 Code; that taxpayer was not exempt for the fiscal year ended April 30, 1951, under Section 302 (a) of the Revenue Act of 1950; that it was not exempt for the fiscal year ended April 30, 1952, by reason of Section 301 (b) of the Revenue Act of 1950, and that the rulings of the Commissioner that taxpayer was not entitled to exemption from taxation for these years were not erroneous. (R. 121–122.)

SUMMARY OF ARGUMENT

1. The District Court correctly held that taxpayer is not entitled to exemption under Section 101 (6) of the 1939 Code, which requires a corporation to show, among other things, that it has been "organized and operated exclusively" for religious, charitable

or educational purposes. The District Court's holding is clearly correct for two reasons. First, exemption must rest in the first instance upon a functional charitable or educational activity and taxpayer did not engage in any functional charitable or educational activity. Secondly, exemption is accorded only to such organizations engaged in a functional charitable or educational activity as are "exclusively" so engaged, and taxpayer was operated for the non-charitable and non-educational purpose of conducting a business for profit. Even if it be conceded that taxpayer has more than one purpose, it clearly had a business purpose, and the presence of such purpose precludes it from showing that it was organized and operated *exclusively* for any of the approved purposes set out in Section 101 (6).

2. It is also clear that taxpayer's income is not exempt, for either year, by virtue of the amendments affecting exempt organizations added by the Revenue Act of 1950. The legislative intent and understanding as reflected in the 1950 Act did not change the pertinent provisions of Section 101 (6), except to further limit the exemption. Furthermore, the 1950 Act made it clear that an organization must carry on exempt functions in order to secure exemption, which taxpayer did not do. In addition, it is clear that taxpayer's income from its security operations constituted unrelated business income, and coupled with taxpayer's failure to carry on exempt activities, this would be a further reason for denying to it any exemption.

ARGUMENT

The District Court correctly held that taxpayer was not "organized and operated exclusively for * * * charitable, * * * or educational purposes" within the meaning of Section 101 (6) of the Internal Revenue Code of 1939, and therefore is not entitled to exemption from tax

A. Under Section 101 (6) of the 1939 Code

In order for an organization to be exempt from income taxes under Section 101 (6) of the 1939 Code (Appendix, *infra*), certain conditions must first be met. The organization must have been organized and operated during the taxable years "exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals." Secondly, no part of the net earnings of the organization could have inured to the benefit of private shareholders or individuals.[2] The long standing Treasury Regulations issued pursuant to Section 101 (6) make it clear that these requirements constitute separate conditions and both are prerequisites to exemption. See Section 29.101 (6)–1 of Treasury Regulations 111 (Appendix, *infra*). Furthermore, this Court has held in *Ralph H. Eaton Foundation* v. *Commissioner,* 219 F. 2d 527, and *John Danz Charitable Tr.* v. *Commissioner,* 231 F. 2d 673, a corporation will not be treated as if it were organized and operated for any of the purposes enumerated in Section 101 (6) merely because its income

[2] There is a third statutory requirement which prohibits the carrying on of propaganda to influence legislation, but that will not be discussed as it does not appear that taxpayer has been so engaged.

is to be used for such purposes, but the corporation itself must function as a religious, educational or charitable institution. Accordingly, we shall begin our consideration with the first requirement of Section 101 (6), the terms of which the District Court held taxpayer did not satisfy.

Involved in this case are the fiscal years beginning May 1, 1950, and ending April 30, 1951, and beginning May 1, 1951, and ending April 30, 1952. Although the Revenue Act of 1950 changed the exemption of charitable and educational organizations, as we shall point out *infra,* these changes did not affect the first requirement of Section 101 (6), that an organization must *function* for one or more of the enumerated purposes and that it must not be operated for other purposes.

The court below held that taxpayer, during the taxable years involved, was not organized or operated exclusively for a charitable purpose within the meaning of Section 101 (6), and, in addition, that the taxpayer was operated during these years for the primary purpose of carrying on a trade or business for profit, and all of its income realized during these years was derived from the operation of its business of buying and selling securities. (R. 121–123.) We submit that such findings are correct and should be affirmed.

The requirement of Section 101 (6) that an organization be "organized and operated exclusively" for certain purposes can be broken down into several conditions. First, the organization must not only be

organized for charitable or educational purposes, but it must also operate or function for such purposes. *John Danz Charitable Tr.* v. *Commissioner,* 231 F. 2d 673 (C. A. 9th); *Ralph H. Eaton Foundation* v. *Commissioner,* 219 F. 2d 527 (C. A. 9th); *United States* v. *Community Services,* 189 F. 2d 421 (C. A. 4th); *Universal Oil Products Co.* v. *Campbell,* 181 F. 2d 451, 457 (C. A. 7th), certiorari denied, 340 U. S. 850. As the Fourth Circuit stated in *Community Services* (p. 425):

> The corporation earning the income and claiming the exemption, rather than the recipients of the income, must be organized and operated exclusively for charitable purpose.

Secondly, by Congress including in the statute the word "exclusively" it is clear that an organization which has as its major purpose one which is non-charitable or non-educational is not entitled to the exemption. As the Supreme Court has made clear in *Better Business Bureau* v. *United States,* 326 U. S. 279, in construing a statute with identical language (p. 283):

> Even the most liberal of constructions does not mean that statutory words and phrases are to be given unusual or tortured meanings unjustified by legislative intent or that express limitations on such an exemption are to be ignored. * * *
>
> In this instance, in order to fall within the claimed exemption, an organization must be devoted to educational purposes exclusively. This plainly means that the presence of a single noneducational purpose, if substantial in

> nature, will destroy the exemption regardless of the number or importance of truly educational purposes. It thus becomes unnecessary to determine the correctness of the educational characterization of petitioner's operations, it being apparent beyond dispute that an important, if not the primary, pursuit of petitioner's organization is to promote not only an ethical but also a profitable business community.

Whether the taxpayer was organized and operated exclusively for a charitable or educational purpose is primarily a factual question to be decided by the trier of fact. Since the findings of fact of the District Court that taxpayer was neither organized or operated exclusively for one of the enumerated purposes, and secondly, that it was operated during these years for nonexempt purposes (R. 121), are amply supported by the evidence, they should not be disturbed on appeal. *United States* v. *Gypsum Co.,* 333 U. S. 364, 395, rehearing denied, 333 U. S. 869.

The record clearly establishes that taxpayer did not engage in any charitable or educational activities during either of the taxable years involved herein. None of taxpayer's trustees took any positive steps or action of a charitable nature, such as the establishment of a home for underprivileged boys, but, to the contrary, Randall testified that he did not intend for taxpayer to engage in any charitable or educational activity until after taxpayer had amassed a quarter of a million dollars, which, he assumed, would require four years. (R. 150, 152–153.) Instead, the only charitable endeavor in which taxpayer participated during its first fiscal year was to make a $500 contribution to a chil-

dren's hospital one week before the close thereof (R. 50, 117–118). During this year it had received $30,-238.27 of net profits from security transactions and $10,285 of dividends, for a total of $40,523.27 (R. 52, 117). In its second year taxpayer's sole charitable activity consisted of $11,200 of contributions made to various charities, approximately 75 per cent of which were made on the last day of the fiscal year and were made to help secure a tax exempt status. (R. 119.) In its second year taxpayer had $50,079.61 of profits from security transactions and $7,081.93 of dividends, or a total of $57,161.54. (R. 52, 119.) Thus, for the two years involved herein, out of $97,684.81 of profits, taxpayer contributed only $11,700 to charity, or approximately one per cent of its profits during the first year and 19 per cent its second year. The paucity of taxpayer's contributions can be explained, however, by reason of the fact that Randall had loaned taxpayer $155,200 (R. 48, 116) so that it would have been impossible for taxpayer to make any substantial contributions as long as these loans were outstanding.[3] But, whatever the reason for the lack of taxpayer's charitable endeavors, it is nevertheless clear that taxpayer failed to carry on such activities during either of these years, so that the District Court was justified in holding that taxpayer was not operated for an exempt purpose. *John Danz Charitable Tr.* v. *Commissioner, supra,* p. 675; *Ralph H. Eaton Foundation* v. *Commissioner, supra,* p. 528.

[3] These loans were repaid as follows: $40,000 on May 29, 1951; $30,000 on December 27, 1951; and $85,200 on February 4, 1952. (R. 48, 117.)

Taxpayer contends, however (Br. 12–17), that it was both organized and operated for charitable purposes on the ground that its original articles clearly stated that it was organized for charitable purposes (R. 16) and its amended articles specified the establishment of a home for underprivileged boys (R. 21), that it operated for these purposes by inspecting properties to find a suitable location for the home, that taxpayer diligently attempted to supplement its income, which is a permissible activity, and that it was not required to expend its fund for exempt purposes where its primary purpose required that its funds be accumulated. We submit that these contentions lack merit.

In the first place, during the years involved, taxpayer's articles did not specify any specific charitable purpose, such as the establishment of a boys' home,[4] but merely provided for general charitable purposes, which would neither justify taxpayer's failure to conduct any charitable activities, nor its accumulation of funds. But even if taxpayer had manifested a primary purpose of establishing a home, its accumulation of funds would not be justified in this case since neither its articles of incorporation (R. 16–20) nor its bylaws (R. 54–60) *required* that any of these funds be earmarked or otherwise dedicated to such purpose,[5]

[4] Taxpayer's articles were first amended on October 7, 1952, to provide for the establishment of a boys' home, which time was subsequent to the taxable years involved herein. (R. 20–23.)

[5] Such a requirement was not introduced into taxpayer's by-laws until September 29, 1952, which was subsequent to the two years involved herein. (R. 62–63.)

and as this Court has held, under similar circumstances in *Danz, supra,* pp. 675–676:

> The mere fact that the remaining funds, after partial or complete recapture from the channels of business or the marts of trade, whenever in a future more or less removed, in the discretion of the Trustees, they chose to pay these over, would necessarily be paid to institutions defined as charitable, does not satisfy the statute. There is another circumstance which compels consideration. John Danz, as settlor, was under no compulsion to exercise his power to designate charitable beneficiaries. If he failed to do so, the funds might during his life have been devoted "exclusively" to business ventures and commercial pursuits.

Instead, during these years, the only provisions in taxpayer's articles of incorporation and by-laws relating to the use of taxpayer's funds were those which provided that the fund could be invested to build up reserves for foundation purposes, that no member shall have any interest in these funds, and upon dissolution or winding up of the corporation its assets shall be distributed to a California religious, educational or charitable organization (R. 18–19, 56, 59). As we have shown, such general provisions as to ultimate destination of taxpayer's income, without more, do not meet the statutory requirement.

Nor does the record support taxpayer's contention that its directors attempted to establish a home for underprivileged boys. The only evidence in this regard was the testimony of Randall (R. 138–140) that the directors looked at various properties during the

first two years, and subsequently, that they made a detailed investigation of how the Father Flanagan Home operates. However, Randall testified that no property was ever purchased for this purpose[6] (R. 139), and the record does not reveal that Randall, or any other director, ever purchased any options on property, had architectural or other plans prepared, or took any steps to have the home established. Furthermore, an examination of the fifteen board of directors meetings held between May 21, 1950, and June 16, 1953 (R. 65–103), does not reveal that the directors were carrying on any sustained charitable or educational activities, but were, instead, primarily concerned with taxpayer's financial transactions. Thus, taxpayer's activities, when realistically analyzed, consisted largely of paper activities, i. e., it did nothing except adopt corporate resolutions and carry on financial transactions, and did not function as a charity.

If this Court should find that taxpayer did not function as a charitable organization this alone would be sufficient to deny taxpayer's claim for exemption, and it would be unnecessary for this Court to examine the additional, albeit separate, ground for denying taxpayer's claim, as was done by the District Court, namely that taxpayer was not organized and operated *exclusively* for the enumerated purposes, but was

[6] The fact that the uncertainty of taxpayer's tax status prevented the carrying out of these steps would clearly be immaterial, particularly since a failure to take any steps to carry out its purpose would have some effect in denying the taxpayer an exempt status.

operated during the years involved "for the primary purpose of carrying on a trade or business for profit." (R. 121.)

In the present case, taxpayer's board of trustees gave to Randall, who was taxpayer's president and sole donor, broad authority over the investment of taxpayer's assets. (R. 131.) Shortly after taxpayer's organization, Randall contributed to taxpayer stocks with a market value of $20,752.11. Some of these shares were sold by Randall on taxpayer's behalf the same day or the day following the contribution. Between June 13, 1950, and April 5, 1951, Randall loaned to taxpayer $155,200 at an interest rate of 2½ percent. These moneys had been borrowed by Randall from his brokers on Randall's personal margin account with his own securities as collateral. (R. 144, 149, 151.) During this period Randall opened margin accounts with his brokers in taxpayer's name. With the proceeds from the sales of the initial contributions and the loans, Randall traded in securities in taxpayer's name. In the first year Randall purchased 26,908 shares of stock and sold 23,185 shares on taxpayer's behalf. Of these transactions, sales of only 150 shares resulted in long-term gain; the remaining sales were short-term transactions. During the second year Randall purchased on taxpayer's behalf 15,936 shares of stock and sold 25,996 shares. Gains were both long-term and short-term. (R. 35–40.)

The securities which Randall purchased and sold for taxpayer (R. 35–40) were primarily oil stocks

listed on the Los Angeles Stock Exchange. In many instances the shares were of small companies, their trading market was "thin," in that there were few transactions in these securities by other persons, so that taxpayer's purchases and sales had a strong effect upon the price of these securities. (R. 133–134.) As a result, Randall often was unable to purchase or sell large blocs of stock at any one time. During the time that Randall was buying and selling on behalf of taxpayer, he was also trading on his own account, although to a lesser extent than previously. (R. 151.) Since taxpayer's security transactions were both substantial and frequent, as distinguished from occasional or isolated ventures, and since they constituted taxpayer's chief, and, for practical purposes, almost its only activity during these years, upon any realistic analysis it appears clear that these transactions constituted the operation of an organization actively engaged in conducting an investment business for profit. *Kales* v. *Commissioner,* 101 F. 2d 35, 39 (C. A. 6th). Cf. *Miller* v. *Commissioner,* 102 F. 2d 476 (C. A. 9th).

Taxpayer's contention (Br. 20–23), that investments are an accepted source of revenue for charities, and that taxpayer's operations in that regard would not constitute a business, lacks merit. Although charities have been permitted to invest their funds, nevertheless it was never intended that permitted investment practice would encompass such transactions as were carried on in this case. The kinds of transactions, the extent of purchases and sales, the short holding period, limited market of the securities purchased, and the

risks entailed from such frequent trading in such securities, stamp taxpayer's activities as speculating rather than as mere investing, and that such speculation was not ancillary to any exempt purpose. As this Court stated in *Danz Charitable Tr.* v. *Commissioner, supra,* pp. 675–676:

> It is plain that these funds, when mingled with the funds of private trusts for business or speculative purposes and considering the risk of loss, were not used exclusively for religious, charitable or other like purposes. * * *
>
> * * * * *
>
> It is difficult to see how a fund is to be "exclusively" devoted to charitable purposes in any event if a part of it is to be used year after year for speculative and business ventures in conjunction with funds which redound to the profit of private individuals. Money is not "used" for charitable purposes when thus traded with. When any portion of this fund is so used, it would be a contradiction in terms to say it was devoted "exclusively" to charitable purposes.

Nor is there any merit to taxpayer's contention that it was not engaged in a business because it did not compete with others in the purchase and sale of securities. Aside from the fact that the theory of stock exchange or "over-the-counter" operation is that competition exists with others in the purchase and sale of stock, it does not appear from the cases that non-enumerated activities would cause an organization to lose its exempt status only if such activities were carried on in competition with tax-paying organizations. Instead, as shown by the rationale of the Supreme

Court in *Better Business Bureau, supra,* the use of the term "exclusively" in Section 101 (6) was intended to deprive an organization of the exemption when carrying on *any* substantial nonexempt activities.[7]

Finally, as pointed out by this Court in *Eaton* and *Danz, supra,* there is no merit to taxpayer's claim (Br. 31–32) that its exempt status is to be measured by the ultimate destination of its income, for it is clear that if an organization either failed to function for exempt purposes, or if it carried on nonexempt activities, it would not be exempt, regardless of the fact that the destination of all its income was to exempt organizations. See also, *United States* v. *Community Services, supra.*

The District Court also concluded (R. 122) that taxpayer was not exempt under Section 101 (14) of the 1939 Code. In this subdivision Congress addressed itself to situations in which a corporation,

[7] It appears that taxpayer's argument misconstrues the Supreme Court's opinion in *Trinidad* v. *Sagrada Orden*, 263 U. S. 578. In that case a religious organization which was otherwise tax exempt undertook as a minor part of its activities to sell wine and chocolate to its member churches, from which activities it received a trivial amount of income. The Government there took the position that these activities deprived the organization of its tax exempt status. In holding that the organization did not lose its exemption, the Supreme Court in its opinion (p. 581) used language suggesting that the question as to whether these activities amounted to engaging in trade or business rests upon whether there is any selling to the public or in competition with others. However, those who rely on the *Sagrada Orden* case should not be allowed to overlook the fact that the taxpayer there was not a business corporation and that the Government had conceded that it had been both organized and operated for religious purposes. Obviously whatever else may be said about that case, it was those significant facts which are the basic reason for the decision.

which does not itself qualify for exemption under subdivision (6) or one of the other subdivisions of that section, dedicates its income to another organization which does qualify. Thus, Congress was fully aware of the possibility that the net earnings of an organization which is not itself organized and operated exclusively for exempt purposes might be destined for other organizations which were so organized and operated. Yet it saw fit to limit the exemption in such cases to corporations whose function was that of "holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses," to exempt organizations. Clearly, in the present case, taxpayer does not qualify under this subdivision.

Furthermore, when Section 101 (14) is read together with Section 101 (6), as it must (*Better Business Bureau* v. *United States, supra*), it is manifest that Congress intended to accord tax exempt status to an organization on the basis of its own purposes and activities, not those of the recipients of its income, except in one type of situation, where a corporation serves merely as a holding and collecting medium for exempt organizations. *United States* v. *Community Services, supra,* p. 425. That Congress did not intend to exempt a business corporation from tax merely because its net income is distributable to a tax exempt organization is also confirmed by Section 23 (q) (2) of the 1939 Code, which limits allowable deductions by a corporation on account of contributions to organizations described in Section 101 (6) to an amount not exceeding 5 percent of its

net income. Both Sections 101 (4) and 23 (q) (2) would be meaningless if, as taxpayer argues (Br. 31–32), the entire net income of a business corporation escapes tax merely because the income is destined for tax exempt organizations.

B. The 1950 Amendments

It is our position that the provisions relating to tax exempt organizations added by the Revenue Act of 1950 do not affect the decision in this case even though the second year involved commenced after the enactment of the 1950 Act, for the reasons that none of the 1950 provisions affected the requirements previously contained in Section 101 (6), that an organization must function as a charity or for a purpose enumerated and cannot carry on nonexempt activities, and because the legislative reports accompanying the 1950 Revenue Act reveal that Congress in 1950, instead of widening the exemption, was attempting to narrow these provisions. The provisions added in 1950 clearly reflect the Congressional intent and understanding that Section 101 (6) does not exempt an organization to which a functional charitable or other enumerated activity cannot be attributed.

By Section 301 (a) of the 1950 Act (Appendix, *infra*), Congress amended Section 421 of the 1939 Code to tax the "unrelated business net income" of *exempt* organizations. The "unrelated business net income" of an *exempt* organization is defined in Section 422 (a) (added by Section 301 (a) of the 1950 Act) as the gross income derived by an organization from any "unrelated trade or business (as defined in subsection (b))" regularly carried on by it, less indicated deduc-

tions and with certain exceptions, including the exclusion from such income of gains or losses from the sale of property other than property held primarily for sale to customers in the ordinary course of the trade or business. The term "unrelated trade or business" is defined in subsection (b) as:

> any trade or business the conduct of which is not substantially related (*aside from* the need of such organization for income or funds or *the use it makes of the profits derived*) to the exercise or performance by such organization *of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 101,* * * * [Italics supplied.]

Thus, by Section 301 of the 1950 Act an exempt organization is taxable on income from a trade or business "which is not substantially related * * * to the exercise or performance * * * of its charitable * * * purpose or function constituting the basis for its exemption under section 101" and that quoted language is not affected by "the need of such organization for [such] income or funds or the use it makes of the profits derived." This unmistakably shows that Congress intended and understood that exemption under Section 101 (6), which was not changed by the 1950 Act, rests upon a functional charitable activity, and that nonrelated business income of an exempt organization would not escape taxation by reason of the fact that the organization needed this income.

Furthermore, contrary to taxpayer's contentions (Br. 18–20), the exclusion of some capital gains from the definition of unrelated business income would not

be applicable here, for the kind of capital gains which Congress intended to permit an organization to have and not lose its exempt status related only to passive income derived from recognized *investments* of an exempt organization, and was not intended to encompass the speculative transactions of the type engaged in by taxpayer, particularly where taxpayer's securities were shown to have been held primarily for sale to customers in the ordinary course of taxpayer's activities. S. Rep. No. 2375, 81st Cong., 2d Sess., pp. 38, 109 (1950–2 Cum. Bull. 483, 511, 560–561).

Nor has taxpayer shown that the provision of Section 422 (b) (Appendix, *infra*), excluding from the definition of an unrelated trade or business one in which substantially all the work is performed for the organization without compensation, applies here, since it has not shown that it was not charged commissions by its brokers for purchasing and selling securities, interest by its donor on loans to enable it to carry on its security transactions, and interest by its brokers for any securities purchased on margin.

Section 301 (b) of the 1950 Act (Appendix, *infra*) added the following paragraph at the end of Section 101 of the Code:

> An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under any paragraph of this section on the ground that all of its profits are payable to one or more organizations exempt under this section from taxation. For the purposes of this paragraph the term "trade or business" shall not include the rental by an organization of its real property (including

personal property leased with the real property).

This is a further indication of the Congressional intent to preclude exemption of organizations not engaged in a functional charitable or other enumerated activity. Nor can taxpayer take advantage of the fact that this provision refers to organizations operated for the "primary" purpose of carrying on a trade or business because it is clear that here taxpayer's primary activity was the carrying on of transactions for profit. Furthermore, as appears from the Report of the Committee on Ways and Means of the House no conclusion can be drawn in taxpayer's favor from the use of the word "primary". H. Rep. No. 2319, 81st Cong., 2d Sess., pp. 41–42, 124 (1950–2 Cum. Bull. 380, 412, 469) states:

> Section 301 (b) of your committee's bill provides that no organization operated primarily for the purpose of carrying on a trade or business (other than the rental of real estate) for profit shall be exempted under section 101 merely on the grounds that all of its profits are payable to one or more organizations exempt from tax under this section. * * *
>
> The effect of this amendment is to prevent the exemption of a trade or business organization under section 101 on the grounds that an organization actually described in section 101 receives the earnings from the operations of the trade or business organization. *In any case it appears clear to your committee that such an organization is not itself carrying out an exempt purpose.* * * * [Italics supplied.]

Moreover, no distinction can be drawn in taxpayer's favor for years prior to 1950, on the basis of Section 301 (b) of the 1950 Act, for Section 303 of the 1950 Act (Appendix, *infra*) provides that:

> The determination as to whether an organization is exempt under section 101 of the Internal Revenue Code from taxation for any taxable year beginning before January 1, 1951, shall be made as if section 301 (b) of this Act had not been enacted and *without inferences drawn from the fact that the amendment made by such section is not expressly made applicable with respect to taxable years beginning before January 1, 1951.* [Italics supplied.]

By Section 301 (b) of the 1950 Act adding the paragraph at the end of Section 101 quoted above and by the provisions of Section 301 (a) taxing the "unrelated business net income" of exempt organizations, Congress has again clearly reflected its intent and understanding that exemption under Section 101 (6) is accorded only to organizations which engage in a functional charitable or other enumerated activity.

The 1950 Act refutes taxpayer's argument (Br. 23–26) that *Community Services, Danz* and *Eaton, supra,* are distinguishable on the ground that these cases involved organizations whose *primary* purpose was the operation of business enterprises, in contrast to taxpayer whose primary purpose, it is claimed, was charitable or educational. Aside from the fact that the record supports the District Court's finding that taxpayer's primary purpose during the years involved was not charitable or educational, the 1950 provisions support the view that in situations such as

here obtains business activity unrelated to a functional charitable or other enumerated activity precludes exemption for years both subsequent and prior to 1951. As already shown, the specific provision added by Section 301 (b) of the 1950 Act precluding exemption of an organization whose primary purpose is to carry on a trade or business for profit was added on the theory that such an organization is not itself carrying out an exempt purpose. H. Rep. No. 2319, *supra.* Thus in the present case, as well as in *Danz, Eaton* and *Community Services,* exemption must be denied.

In addition, the 1950 Act clearly shows that, for years prior to 1951, the effect of business activity in denying exemption (even as to an organization engaged in a functional charitable or other enumerated activity) depends upon the relation of the trade or business in which the organization is engaged to its exempt functions. Section 302 (a) of the 1950 Act (Appendix, *infra*) provides as follows:

> SEC. 302. EXEMPTION OF CERTAIN ORGANIZATIONS FOR PAST YEARS.
>
> (a) *Trade or Business Not Unrelated—For any taxable year beginning prior to January 1, 1951,* no organization shall be denied exemption under paragraph * * * (6) * * * of section 101 of the Internal Revenue Code on the grounds that it is carrying on a trade or business for profit if the income from such trade or business would not be taxable as unrelated business income under the provisions of Supplement U of the Internal Revenue Code, as amended by this Act, or if such trade or business is the

> rental by such organization of its real property (including personal property leased with the real property). [Italics supplied.]

As we have already shown, "unrelated business net income" means income from a trade or business which is not substantially related to the exercise or performance by an organization "of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 101" excluding from consideration the destination of such profits (Section 301 (a) of the 1950 Act). As to years prior to 1951 (which includes the first year involved), Section 302 (a) of the 1950 Act has the effect of providing that an organization is not to be denied exemption if its business income is substantially related to the exercise or performance of its functional charitable or other enumerated activity or activities. The plain inference is that an organization which has business income which is *not* related to a functional charitable or other enumerated activity of the organization must be *denied* exemption for years prior to 1951.

Since taxpayer's security transactions during the years involved were not related to its charitable or educational purposes as expressed in its articles of incorporation and by-laws, or as carried out by taxpayer, and since, as we have shown, *supra,* taxpayer's income was not excluded from the definition of unrelated business income of Section 422 (b) (Section 301 (a) of the 1950 Act), taxpayer would not be exempt under Section 302 (a) of the 1950 Act for its first year, as contended by it. (Br. 18–20.)

Section 331 of the 1950 Act (Appendix, *infra*)

added two provisions to the 1939 Code, Sections 3813 and 3814, which prohibited certain transactions by charitable organizations. Section 3813 prohibits various types of transactions which might result in the diversion of the income or corpus of the organization, directly or indirectly, to any person who has made a substantial contribution to such organization. Section 3814 (Appendix, *infra*) provides that exemption under Section 101 (6) shall be denied to an organization if any of the following situations exist: accumulations out of income, during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year which are either unreasonable in amount or duration in order to carry out the organization's exempt purposes, or are misused to a substantial degree for purposes or functions other than the organization's exempt purposes, or are invested in such a manner as to jeopardize the carrying out of the organization's exempt purposes. The effect of adding this provision is to deny exemption to what may have been an exempt organization when its accumulation of income becomes unreasonable or its income is misused. As we have already shown, since taxpayer's purposes did not define the need for an accumulation of its income, and since there were not any provisions earmarking its income for these purposes, and since taxpayer's continuous security transactions constituted a risk of its funds, Section 3814 would in addition to other provisions deny to taxpayer an exemption.

Thus, it is clear that the 1950 Act presents reasons in addition to those inherent in Section 101 (6) for denying the exemption to taxpayer for both years.

CONCLUSION

The decision of the District Court is correct and should be affirmed by this Court.

Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1939:

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

The following organizations shall be exempt from taxation under this chapter—

* * * * *

(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

* * * * *

(26 U. S. C. 1952 ed., Sec. 101.)

Revenue Act of 1950, c. 994, 64 Stat. 906:

TITLE III—TREATMENT OF INCOME OF, AND GIFTS AND BEQUESTS TO, CERTAIN TAX-EXEMPT ORGANIZATIONS

Part I—Taxation of Business Income of Certain Tax-Exempt Organizations

SEC. 301. INCOME OF EDUCATIONAL, CHARITABLE, AND CERTAIN OTHER EXEMPT ORGANIZATIONS

(a) *Tax on Certain Types of Income.*—Supplement U of chapter 1 is hereby amended to read as follows:

SUPPLEMENT U.—TAXATION OF BUSINESS INCOME OF CERTAIN SECTION 101 ORGANIZATIONS

SEC. 421. IMPOSITION OF TAX.

(a) *In General.*—There shall be levied, collected and paid for each taxable year beginning after December 31, 1950—

(1) upon the supplement U net income (as defined in subsection (c)) of every organization described in subsection (b) (1), a normal tax of 25 per centum of the supplement U net income, and a surtax of 20 per centum of the amount of the supplement U net income in excess of $25,000.

* * * * *

(b) *Organizations Subject to Tax.*—

(1) *Organizations taxable as corporations.*—The taxes imposed by subsection (a) (1) shall apply in the case of any organization (other than a church, a convention or association of churches, or a trust described in paragraph (2)) which is exempt, except as provided in this supplement, from taxation under this chapter by reason of paragraph (1), (6), or (7) of section 101. Such taxes shall also apply in the case of a corporation described in section 101 (14) if the income is payable to an organization which itself is subject to the tax imposed by subsection (a) or to a church or to a convention or association of churches.

* * * * *

(c) *Definition of Supplement U Net Income.*—The term "supplement U net income" of an organization means the amount by which its unrelated business net income (as defined in section 422) exceeds $1,000.

* * * * *

SEC. 422. UNRELATED BUSINESS NET INCOME

(a) *Definition.*—The term "unrelated business net income" means the gross income derived by any organization from any unrelated trade or business (as defined in subsection (b)) regularly carried on by it, less the deductions allowed by section 23 which are directly connected with the carrying on of such trade or business, subject to the following exceptions, additions, and limitations:

(1) There shall be excluded all dividends, interest, and annuities, and all deductions directly connected with such income.

* * * * *

(5) There shall be excluded all gains or losses from the sale, exchange, or other disposition of property other than (A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or (B) property held primarily for sale to customers in the ordinary course of the trade or business. This paragraph shall not apply with respect to the cutting of timber which is considered, upon the application of section 117 (k) (1), as a sale or exchange of such timber.

* * * * *

(b) *Unrelated Trade or Business.*—The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 421 (a), any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 101, * * *, except that such term shall not include any trade or business—

* * * * *

(1) in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or

* * * * *

(b) *Feeder Organizations.*—Section 101 is hereby amended by adding at the end thereof the following paragraph:

An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under any paragraph

of this section on the ground that all of its profits are payable to one or more organizations exempt under the section from taxation. For the purposes of this paragraph the term "trade or business" shall not include the rental by an organization of its real property (including personal property leased with the real property).

(c) *Technical Amendments.*

(1) Section 101 is hereby amended (A) by striking out "The following organizations shall be exempt" and inserting in lieu thereof "Except as provided in supplement U, the following organizations shall be exempt", and (B) by adding at the end of such section (following the paragraph added by subsection (b) of this section) the following paragraph:

Notwithstanding supplement U, an organization described in this section (other than in the preceding paragraph) shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

* * * * *

(26 U. S. C. 1952 ed., Secs. 101, 421, 422.)

SEC. 302. EXEMPTION OF CERTAIN ORGANIZATIONS FOR PAST YEARS

(a) *Trade or Business Not Unrelated.*—For any taxable year beginning prior to January 1, 1951, no organization shall be denied exemption under paragraph (1), (6), or (7) of section 101 of the Internal Revenue Code on the grounds that it is carrying on a trade or business for profit if the income from such trade or business would not be taxable as unrelated business income under the provisions of Supplement U of the Internal Revenue Code, as amended by this Act, or if such trade or business is the rental by such organization of its real property (including personal property leased with the real property).

* * * * *

SEC. 303. EFFECTIVE DATE OF PART I

The amendments made by this part shall be applicable only with respect to taxable years beginning after December 31, 1950. The determination as to whether an organization is exempt under section 101 of the Internal Revenue Code from taxation for any taxable year beginning before January 1, 1951, shall be made as if section 301 (b) of this Act had not been enacted and without inferences drawn from the fact that the amendment made by such section is not expressly made applicable with respect to taxable years beginning before January 1, 1951.

* * * * *

PART III—LOSS OF EXEMPTION UNDER SECTION 101 (6) AND DISALLOWANCE OF CERTAIN GIFTS AND BEQUESTS

SEC. 331. EXEMPTION OF CERTAIN ORGANIZATIONS UNDER SECTION 101 (6) AND DEDUCTIBILITY OF CONTRIBUTIONS MADE TO SUCH ORGANIZATIONS

Chapter 38 is hereby amended by inserting at the end thereof the following new sections:

* * * * *

SEC. 3814. DENIAL OF EXEMPTION UNDER SECTION 101 (6) IN THE CASE OF CERTAIN ORGANIZATIONS ACCUMULATING INCOME

In the case of any organization described in section 101 (6) to which section 3813 is applicable, if the amounts accumulated out of income during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year—

(1) are unreasonable in amount or duration in order to carry out the charitable, educational, or other purpose or function constituting the basis for such organization's exemption under section 101 (6); or

(2) are used to a substantial degree for purposes or functions other than those constituting

the basis for such organization's exemption under section 101 (6); or

(3) are invested in such a manner as to jeopardize the carrying out of the charitable, educational, or other purpose or function constituting the basis for such organization's exemption under section 101 (6), exemption under section 101 (6) shall be denied for the taxable year.

(26 U. S. C. 1952 ed., Sec. 3814.)

SEC. 332. TECHNICAL AMENDMENTS

* * * * *

(c) *Amendment of Section 101 (6).*—Section 101 (6) is hereby amended by striking out "legislation;" and inserting in lieu thereof the following: "legislation. For loss of exemption under certain circumstances, see sections 3813 and 3814,".

* * * * *

(26 U. S. C. 1952 ed., Sec. 101.)

SEC. 333. EFFECTIVE DATES

Subsections (c) and (d) of section 3813 and section 3814 of the Internal Revenue Code, added by section 331 of this Act, shall apply with respect to taxable years beginning after December 31, 1950, and subsection (e) of section 3813 of the Internal Revenue Code shall apply only with respect to gifts or bequests (as defined in section 3813 of the Internal Revenue Code) made on or after January 1, 1951.

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.101 (6)–1. [As amended by T. D. 5928 (1952–2 Cum. Bull. 181).] *Religious, Charitable, Scientific, Literary, And Educational Organizations And Community Chests.*—In order to be exempt under section 101 (6), the organization must meet three tests:

(1) It must be organized and operated exclusively for one or more of the specified purposes;

(2) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals; and

(3) It must not by any substantial part of its activities attempt to influence legislation by propaganda or otherwise.

Corporations organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor. The fact that a corporation established for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily deprive it of exemption.

An educational organization within the meaning of the Internal Revenue Code is one designed primarily for the improvement or development of the capabilities of the individual, but, under exceptional circumstances, may include an association whose sole purpose is the instruction of the public, or an association whose primary purpose is to give lectures on subjects useful to the individual and beneficial to the community, even though an association of either class has incidental amusement features. An organization formed, or availed of, to disseminate controversial or partisan propaganda is not an educational organization within the meaning of the Code. However, the publication of books or the giving of lectures advocating a cause of a controversial nature shall not of itself be sufficient to deny an organization the exemption, if carrying on propaganda, or otherwise attempting, to influence legislation forms no substantial part of its activities, its principal purpose and substantially all of its activities being clearly of a nonpartisan, noncontroversial, and educational nature.

Since an organization exempt under Section 101 (6) must be organized and operated exclusively for one or more of the specified purposes, an organization organized and operated for the primary purpose of carrying on a trade or business for profit is not exempt thereunder. Thus, such an organization is not exempt under Section 101 (6) even though it has certain religious purposes, its property is held in common, and its profits do not inure to the benefit of individual members of the organization. * * *

A corporation otherwise exempt under section 101 (6) does not lose its status as an exempt corporation by receiving income such as rent, dividends, and interest from investments, provided such income is devoted exclusively to one or more of the purposes specified in that section.

U. S. GOVERNMENT PRINTING OFFICE: 1956

No. 15076

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

RANDALL FOUNDATION, INC.,

Appellant,

vs.

ROBERT A. RIDDELL, DIRECTOR OF INTERNAL REVENUE, DISTRICT OF LOS ANGELES,

Appellee.

APPELLANT'S REPLY BRIEF.

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APPELLANT'S REPLY BRIEF.

Statement of the Facts.

The primary or evidential facts stated by Appellee are substantially correct though incomplete. However, Appellee repeats therein the erroneous findings of fact objected to in the Specification of Errors in Appellant's Opening Brief that trading in securities and receiving dividends were taxpayer's *only* activities during its first year of existence and that *no* charitable activity was directly carried on during its second fiscal year. It also repeats as facts the erroneous legal conclusions set forth in the findings of fact that taxpayer was not organized or operated exclusively for charitable purposes during the fiscal years ended April 30, 1951 and April 30, 1952 and that taxpayer was operated for the primary purpose of carrying on a trade or business for profit in those years.

A. An Appellate Court May Freely Substitute Its Judgment for That of the Trial Court on Questions of Law, Mixed Questions of Law and Fact and in Determining the Legal Significance of the Primary Facts. Where, as Here, the Primary Facts Are Undisputed, This Court May Substitute Its Judgment for That of the Trial Court Regardless of Whether the Trial Court Denominated Its Conclusions as Findings of Fact or Conclusions of Law.

Appellee suggests at page 12 of its Brief that this Court's review of the Trial Court's findings of fact is limited to a determination of whether they are supported by the evidence. Such a rule has no applicability to the present case.

As Appellee itself stated in its trial Brief [Def.'s Tr. Br. 3], the facts in this case are largely undisputed. The principal facts were stipulated [R. 44-104] and the evidence submitted at the trial consisted of uncontroverted testimony explaining and clarifying these stipulated facts [R. 125, *et seq.*]. The Trial Court determined on the basis of these undisputed facts that taxpayer was not organized and operated for charitable purposes within the meaning of Section 101(6) and was operated primarily for the purpose of carrying on a trade or business for profit. This conclusion was stated both as a finding of fact and a conclusion of law. But, however denominated, it is apparent from any consideration of the record and of the questions discussed in the briefs before this Court, that the sole question decided by the Trial Court and presented on this appeal is whether on the basis of the undisputed primary or evidentiary facts, Appellant is entitled to exemption under Internal Revenue Code Section 101(6) in the light of the Revenue Act of 1950.

Under these circumstances, this Court may freely substitute its judgment for that of the court below.

Bogardus v. Commissioner of Int. Rev. (1937), 302 U. S. 34.

"The Board of Tax Appeals concluded that, from a careful consideration of all the evidence, 'the payments made by Unopco to the petitioners and others were additional compensation in consideration of services rendered to Universal and were not tax-free gifts.' This, as we recently have pointed out, is 'a conclusion of law or at least a determination of a mixed question of law and fact. It is to be distinguished from the findings of primary, evidentiary or circumstantial facts. It is subject to judicial review and, on such review, the court may substitute its judgment for that of the board.' Helvering v. Tex-Penn Oil Co., 300 U. S. 481, 491, 81 L. ed. 755, 762, 57 S. Ct. 569; Helvering v. Rankin, 295 U. S. 123, 131, 79 L. ed. 1343, 1349, 55 S. Ct. 732. * * *"

Bogardus v. Commissioner of Int. Rev., 302 U. S. 34, 38;

Exmoor Country Club v. United States (7th Cir., 1941), 119 F. 2d 961;

Kwikset Locks v. Hillgren (9th Cir., 1954), 210 F. 2d 483, cert. den. 347 U. S. 989, *cert. den.* 348 U. S. 855;

Kemart Corp. v. Printing Arts Research Laboratories (9th Cir., 1953), 201 F. 2d 624;

Kaufmann v. Commissioner of Internal Revenue (3rd Cir., 1930), 44 F. 2d 144;

Offutt v. United States (1954), 348 U. S. 11, 99 L. Ed. 11.

B. Appellant Had No Unrelated Business Income as Defined in Supplement U. The Revenue Act of 1950 Therefore Prohibits Denial of Its Exemption on the Grounds That It Was Carrying on a Trade or Business for a Profit.

Appellant's Opening Brief stressed the importance of Section 302(a) of the Revenue Act of 1950. This section provides:

> ". . . For any taxable year beginning prior to January 1, 1951, no organization shall be denied exemption under paragraph * * * (6) * * * of section 101 of the Internal Revenue Code on the grounds that it is carrying on a trade or business for profit if the income from such trade or business would not be taxable as unrelated business income under the provisions of Supplement U of the Internal Revenue Code, as amended by this Act, or if such trade or business is the rental by such organization of its real property (including personal property leased with the real property)."

Thus, even assuming contrary to the fact, that taxpayer could be said to be engaged in the trade or business of buying and selling securities for a profit by reason of its securities transactions, Section 302(a) specifically prevents denial of its exemption on this ground. Section 302(a) is expressly applicable to Appellant's fiscal year ended April 30, 1951 and, as was discussed in Appellant's Opening Brief, other provisions of the 1950 Revenue Act impliedly require the same result for subsequent years [App.'s Op. Br. 28, *et seq.*]. Appellee's only answer to this clear statutory mandate is to argue that Appellant cannot qualify under Section 302(a) because it had unrelated business income as defined by Supplement U

(Sections 421 *et seq.* of the 1939 Internal Revenue Code as amended by the Revenue Act of 1950) [Appellee's Br. 23-24].

A careful examination of Section 422 clearly shows that Appellant had no unrelated business income because of two separate and independent provisions:

(1) Section 422(a) defines unrelated business net income as being income from an unrelated trade or business with certain specified exceptions. Section 422(b) defines unrelated trade or business and, in doing so, expressly excludes any trade or business

> "in which substantially all the work in carrying on such trade or business is performed for the organization without compensation."

Appellee suggests [Tr. Br. 24] that taxpayer may not qualify under this section because it has not shown that it was not charged commissions by brokers for purchasing and selling securities nor interest on moneys borrowed. Appellee need not have stated this in the negative since the record affirmatively shows, and Appellant concedes, that normal brokerage commissions and interest were paid. Though these items may be considered expenses of the business, they certainly cannot be considered compensation for *work* performed in carrying on the trade or business. The brokerage houses involved were independent contractors, paid a regular brokerage commission and not employees of Appellant.

It would require an unwarrantedly broad construction of Section 422(b) to include such brokerage commissions as compensation for work performed in carrying on Appellant's trade or business. It would require an even more unique construction to also include interest paid on money borrowed as compensation for work performed.

However, even were the statute so construed, it is apparent from the record that *substantially* all of the work performed in carrying on Appellant's stock market activities was performed by Mr. Randall. He was not compensated for his services. Compensation to other persons would therefore not prevent exemption under Section 422(b). Moreover, even if Appellant's exemption on this ground were completely ignored, there is an independent ground which clearly prevents it from having unrelated business income.

(2) Section 422(a) specifically provides in defining unrelated business income that:

> "(1) There shall be excluded all dividends, interest, and annuities, and all deductions directly connected with such income.
>
> * * * * * * * *
>
> "(5) There shall be excluded all gains or losses from the sale, exchange, or other disposition of property other than (A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or (B) property held primarily for sale to customers in the ordinary course of the trade or business. * * *"

All of Appellant's income fell in one of these two excluded categories. This seemed so clear that Appellant did not discuss this issue further in its Opening Brief. However, Appellee has now suggested that the inclusion of capital gains under Section 422(a)(5) is limited to

only certain capital gains and was not intended to include gains from the speculative transactions engaged in by taxpayer "particularly where taxpayer's securities were shown to have been held primarily for sale to customers in the ordinary course of taxpayer's activities." The only authority cited is the Senate Committee Report to Section 422.

Appellant has carefully studied both the House and Senate Committee Reports to the 1950 Revenue Act. It could find nothing there or elsewhere to even remotely suggest that Section 422(a)(5) was intended to exclude some capital gains and not others. On the contrary, it seems abundantly clear that Section 422(a)(5) was intended to exclude *all* capital gains. As quoted above, Section 422(a)(5) excludes gains and losses from the sale or exchange of property other than

> ". . . (A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or (B) property held primarily for sale to customers in the ordinary course of the trade or business. * * *"

The quoted portion of Section 422(a)(5) is taken verbatim from Section 117(a) of the 1939 Internal Revenue Code defining capital gains and losses. Long before the 1950 Revenue Act, this language had acquired a well-known and specific meaning. It has been consistently held (in decisions formally acquiesced in by the Commissioner) under Section 117(a) that regardless of the type of stocks bought and sold, the length of time they are held or the

volume of purchases and sales made, gains from sales of securities held for one's own account are capital gains. The only sales of securities not so qualifying as property other than of "stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business" are sales by *dealers* of securities which they acquired to sell *to their customers* rather than for their own account.

Pacific Affiliate, Inc. (1952), 18 T. C. 1175 at 1212 (Acq. C. B. 1953-19,1);

George R. Kemon (1951), 16 T. C. 1026;

Carl Marks & Co. (1949), 12 T. C. 1196;

I. T. 3891, 1948-1, C. B. 69.

Appellee concedes, as it must, that Appellant is not a dealer in securities [Appellee's Br. 5]. It thereby necessarily concedes that Appellant's sales of securities were of property other than "stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business" as that phrase is used in Section 117(a). Appellant submits that there is no basis for giving the quoted phrase a different meaning when used in Section 422(a)(5). All of Appellant's income is therefore excluded from unrelated business income under either Section 422(a)(1) or (5).

C. Appellant Was Organized and Operated Exclusively for Charitable Purposes Within the Meaning of Section 101(6) of the 1939 Internal Revenue Code.

Appellant set forth in its Opening Brief the reasons and authorities which establish that it was organized and operated for charitable purposes within the meaning of Section 101(6) of the 1939 Internal Revenue Code. It also set forth the reasons why, even apart from the 1950 amendments, its purchases and sales of securities were not activities of a type which would warrant denial of exemption on the ground that Appellant was not exclusively operated for the charitable purposes for which organized. No useful purpose could be served by reiterating the points there made under the guise of rebuttal argument. Appellant will therefore restrict itself to a few brief comments on the new matters raised in Appellee's Brief.

1. At pages 14 and 15 Appellee suggests that Appellant cannot qualify for exemption because its original Articles and By-Laws did not require its funds to be dedicated to a specific charitable purpose at a specific time. Appellant does not, and cannot, deny that Appellant's original Articles and By-Laws unequivocally and unconditionally dedicated all of taxpayer's assets to general charitable purposes and that Appellant's primary purpose has always been to establish a home for underprivileged boys. No previous case has suggested that it was not sufficient to thus irrevocably dedicate an organization's assets to general charitable purposes and Appellant submits that any stricter rule would be both unwarranted and undesirable.

2. It is interesting to note that the only cases cited by Appellee to support its conclusion that Appellant was engaged in conducting an investment business for a profit and hence not operated exclusively for charitable purposes was the decision of the Sixth Circuit in *Kales v. Commissioner of Internal Revenue* (6th Cir., 1939), 101 F. 2d 35, 39 and the decision of this Court in *Miller v. Commissioner of Internal Revenue* (9th Cir., 1939), 102 F. 2d 476 [Appellee's Br. 18]. These were part of a long line of cases in which the Commissioner of Internal Revenue took the position that no matter how extensive taxpayer's activities were, purchases and sales of securities for ones own account could *not* qualify as a trade or business for purposes of allowing deduction of the expenses related thereto. The *Kales* case was one of the few which rejected this and held for the taxpayer. The *Miller* case distinguished *Kales* and refused to allow deductibility. The United States Supreme Court granted certiorari in *Higgins v. Commissioner of Internal Revenue* (1941), 312 U. S. 212 because of the conflict between the *Kales* decision and those in other circuits. It held that no matter how extensive the taxpayers activities it could not, as a matter of law, determine that he was engaged in a trade or business. (Congress thereafter amended the statute to allow deductibility of expenses for production of income even though taxpayer was not engaged in a trade or business.) It is only fair to add that even though the *Higgins* case is favorable, Appellant does not feel that this is the crucial point before this

Court. It is, of course, significant that Appellant was not in the trade or business of buying and selling securities. But the factor of prime importance is that its purchases and sales of securities were an activity which in no way prevented the dominance of its charitable purposes. Purchases and sales of stocks and bonds (as contrasted with conducting a commercial trade or business) is merely a means of obtaining funds for an organization's charitable purposes and is in no way inconsistent therewith. A charitable organization must raise funds as well as spend them. Exemption can properly be denied only where the organization engages in business activities which by their nature are permanent commercial activities of a type unrelated to and not properly subordinate to the organization's charitable purposes. In contrast to such business activities, purchases and sales of stocks and bonds are an investment activity which has long been recognized as a proper activity for charitable organizations. The volume of purchases and sales does not change its basic investment nature. This is affirmed by Section 422 of the 1939 Internal Revenue Code which excludes such income from the definition of unrelated business income, and hence from tax under the 1950 amendments, regardless of the volume of sales as long as the seller is not a dealer in securities selling to his customers.

D. The Decisions of This Court in the Eaton and Danz Cases Do Not Control the Present Case.

Appellee has cited virtually no relevant cases other than *Eaton and Danz.* It has quoted at length from the *Danz* opinion though it is appropriate to note that all of its quotations were from portions of the opinion dealing with obtaining a charitable deduction for funds "permanently set aside" for charitable purposes and were not applied by this Court to its discussion of whether the trust should be exempt. It is apparent that both Appellee and the court below feel that the *Danz* and *Eaton* decisions control the present case. Appellant feels that they clearly do not and hence has again set forth below, in the light of Appellee's Brief, the basic reasons why the *Eaton* and *Danz* cases do not, and cannot, control this decision.

1. *The Revenue Act of 1950:* Both cases involved tax years prior to the effective date of the Revenue Act of 1950. The applicability of Section 302(a) of the Revenue Act of 1950 was not discussed in either the *Danz* case or the *Eaton* case. We doubt if it was even raised since it seems apparent that both the Eaton Foundation and the Danz Trust had unrelated business income from their commercial activities and could not have qualified under Section 302(a). There was therefore no statutory bar to denying exemption to them by reason of the commercial trades and business in which they were engaged.

Appellant, on the other hand, had no unrelated business income. Thus by express statutory mandate Appellant is entitled to exemption for its fiscal year ended April 30. 1951 whether or not this Court would otherwise have concluded that its purchases and sales of securities would have prevented it from being operated exclusively for

charitable purposes. The Commitee Reports discussed at page 32 in Appellant's Opening Brief show that Congress intended the same rule to apply in subsequent years. As stated in the conclusion to Appellant's Opening Brief, it is this Congressional intent which clearly controls the present case.

2. *Internal Revenue Code, Section 101(6):* Completely apart from the reasons discussed in 1, Appellant's case clearly differs in crucial respects from the *Eaton* and *Danz* cases so that even without the aid of the Revenue Act of 1950 it would be entitled to exemption.

Section 101(6) requires that an organization must be "operated exclusively for . . . charitable . . . purposes." The three factors essential to the determination in the *Eaton* and *Danz* cases that those organizations were not operated exclusively for charitable purposes were:

a. They operated commercial activities such as farming, selling sports clothes, and operating a construction business, candy shops and a hotel.

b. They never intended to themselves engage in any charitable activities except indirectly by their gifts to other charitable organizations.

c. They were in competition with taxpaying business.

This Court wisely restricted its opinions to the specific situations before it and gave no indication of the rules which should be applied to other situations. Yet Appellee in its Opening Brief, by choosing isolated phrases from this Court's opinions in those cases, attempts to establish a *general* rule that an organization must function directly as a charitable organization by dispensing directly charitable

benefits in order to qualify under Section 101(6); that indirectly functioning by making gifts to other charities which in turn directly dispense charitable benefits is not enough.

There are so many thousands of charitable organizations in existence in this country today which have been granted exemption and which only function in this indirect manner that it is proper for this Court to take judicial notice of that fact. Furthermore, as stated on page 17 of Appellant's Opening Brief, the Bureau of Internal Revenue in 1924 specifically ruled that such indirect activity was sufficient, and this ruling has never since been overruled or questioned. These facts eloquently refute the general rule claimed by Appellee.

But beyond this, the present case involves a foundation organized and operated to itself conduct charitable activities and not merely to supply funds with which other organizations might do so. It did not compete with tax-paying business and did not engage in commercial activities. It has been denied exemption solely because the principal charitable objective selected required an accumulation of from two to four years before it could be fulfilled and because it actively bought and sold stocks to help accumulate funds for its charitable objective. Appellant earnestly submits that unlike the activities in the *Eaton* and *Danz* cases, the activities engaged in by Appellant did not make it any the less operated exclusively for charitable purposes as required by Section 101(6) of the 1939 Internal Revenue Code.

Respectfully submitted,

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By BERT A. LEWIS,

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